3

Advanced Issues in Partnership Accounts

Unit - 1 : Dissolution of Partnership Firms

Learning Objectives

After studying this unit, you will be able to:

- Go through the circumstances in which a partnership is dissolved.
- Understand that on dissolution of a partnership all assets are sold out and all liabilities are discharged. Learn the accounting technique relating to disposal of assets and payment of liabilities.
- Learn how to settle the partner's claims in case of surplus and how to raise money from partners in case of deficit.
- Deal with piecemeal distribution to partners of amount realized from assets net of liabilities.

1.1 Introduction

Apart from readjustment of rights of partners in the share of profit by way of change in the profit sharing ratio and admission of a new partner or for retirement/death of a partner, another important aspect of partnership accounts is how to close books of accounts in case of dissolution. In this Unit, we shall discuss the circumstances leading to dissolution of a partnership firm and accounting treatment necessary to close its books of accounts. Also we shall discuss the special problems relating to insolvency of partners and settlement of partnership's liabilities.

1.2 Circumstances Leading to Dissolution of Partnership

A partnership is dissolved or comes to an end on:

(a) the expiry of the term for which it was formed or the completion of the venture for which it was entered into;

(b) death of a partner;

(c) insolvency of a partner;

(d) retirement of a partner;

However, the partners or remaining partners (in case of death, insolvency or retirement) may continue to do the business. In such case there will be a new partnership but the firm will continue. When the business comes to an end then only it will be said that the firm has been dissolved.

A firm stands dissolved in the following cases:

(i) The partners agree that the firm should be dissolved;

(ii) All partners except one become insolvent;

(iii) The business becomes illegal;

(iv) In case of partnership at will, a partner gives notice of dissolution; and

(v) The court orders dissolution.

The court has the option to order dissolution of a firm in the following circumstances :

(a) Where a partner has become of unsound mind;

(b) Where a partner suffers from permanent incapacity;

(c) Where a partner is guilty of misconduct of the business;

(d) Where a partner persistently disregards the partnership agreement;

(e) Where a partner transfers his interest or share to a third party;

(f) Where the business cannot be carried on except at a loss; and

(g) Where it appears to be just and equitable.

1.3 Consequences of Dissolution

On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards the capital contributed by partners is repaid and, if there is still surplus, it is distributed among the partners in their profit-sharing ratio.

Conversely, after payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm left over are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their profit-sharing ratio.

According to the provisions contained in section 48 of the Partnership Act, upon dissolution of partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

(a) Losses including deficiencies of capital are paid, first out of profits, next out of capital

and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:

   (i) in paying the debts of the firm to third parties;

   (ii) in paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital;

   (iii) in paying to each partner what is due to him on account of capital; and

   (iv) the residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.

The death or retirement of a partner would not result in the dissolution of the partnership.

1.3.1 Dissolution before expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund if the firm is dissolved before the term has expired.

No claim in this respect will arise if:

(1) the firm is dissolved due to the death of a partner;

(2) the dissolution is mainly due to the partner's (claiming refund) own misconduct; and

(3) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it. [Section 50]

The amount to be repaid will be such as is reasonable having regard to the terms upon which the admission was made and to the length of period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit- sharing ratio.

1.4 Closing of Partnership Books on Dissolution

We will illustrate the required journal entries to be made for closing the books of a firm with the example given below:

Balance Sheet of Fast and Quick as at Dec. 31, 2011

Liabilities		₹	*Assets*		₹
Sundry Creditors		20,000	Plant and Machinery		40,000
Fast's Loan		10,000	Patents		6,000
General Reserve		10,000	Stock		25,000
Capitals:			Sundry Debtors	19,000	
Fast	30,000		*Less:* Prov. for doubtful debts	(1,000)	18,000

Quick	25,000	55,000	Cash		6,000
		95,000			95,000

Fast and Quick share profits in the ratio of 3:2. On 1st January, 2012 the firm was dissolved. Fast took over the patents at a valuation of ₹ 5,000. The other assets realised as under:

	₹
Goodwill	15,000
Plant and Machinery	30,000
Stock	22,000
Sundry Debtors	18,500
Total	85,500

The Sundry Creditors were paid off at a discount of 5%. The expense amounted to ₹ 3,500. The steps to close the books are given below:

I. Open a **Realisation Account** and **transfer all assets** except cash in hand or at bank at book values. Realisation Account is debited and the various assets are credited and thus closed. It should be remembered that Sundry Debtors and Provisions for Bad Debts Accounts are two separate accounts and the gross amount of debtors should be transferred. In the above example the entry will be:

		₹	₹
Realisation Account	Dr.	90,000	
To Plant and Machinery Account			40,000
To Patents Account			6,000
To Stock Account			25,000
To Sundry Debtors			19,000
(Transfer of various assets to the debit side of Realisation Account)			

II. **Transfer of liabilities** to outsiders and provisions and reserves against assets (e.g., Provision for Doubtful Debts) to the credit side of Realisation account. The accounts of the liabilities and provisions will be debited and thus closed. The entry should be at book figures. The entry will be:

		₹	₹
Sundry Creditors Account	Dr.	20,000	
Provision for Doubtful Debts Account	Dr.	1,000	
To Realisation Account			21,000
(Transfer of liabilities to outsiders and provision against debtors to Realisation Account)			

Note: Accounts denoting accumulated losses or profits should not be transferred to the Realisation Account.

III. (i) The Realisation Account should be **credited with the actual amount realised by sale of assets**. This should take no note of the book figures. Of course, Cash (or Bank) Account will be debited. Thus:

	₹	₹
Cash Account Dr.	85,500	
To Realisation Account		85,500
(Amount realised by sale of various assets)		

(ii) If a **partner takes over an asset**, his Capital Account should be debited and Realisation Account credited with the value agreed upon, Thus:

	₹	₹
Fast's Capital Account Dr.	5,000	
To Realisation Account		5,000
(Patents taken over by Fast at ₹ 5,000)		

IV. **Expenses of dissolution** or realisation of assets are debited to the Realisation Account and credited to Cash Account. Thus

	₹	₹
Realisation Account Dr.	3,500	
To Cash Account		3,500
(Payment of Expenses)		

V. (i) The actual amount **paid to creditors** should be debited to the Realisation Account and Cash Account is credited:

	₹	₹
Realisation Account Dr.	19,000	
To Cash Account		19,000
(Payment of Sundry Creditors ₹ 20,000 less 5%)		

(ii) If any **liability is taken over by a partner**, his Capital Account should be credited and Realisation Account debited with the amount agreed upon.

VI. At this stage, the Realisation Account will show **profit or loss**. If the debit side is bigger, there is a loss; if the credit side is bigger, there is a profit. Profit or loss is transferred to the Capital Accounts of partners in the profit sharing ratio. In case of profit, Realisation Account is debited and Capital Accounts credited. The entry for loss is, naturally, reverse of this entry. The Realisation Account in the example given above shows a loss of ₹ 1,000 (see account below).

		₹	₹
Fast's Capital Account	Dr.	600	
Quick's Capital Account	Dr.	400	
To Realisation Account			1,000
(Transfer of loss to Capital Account in the ratio of 3:2)			

VII. **Partner's Loans** if any, should now be paid. The entry is to debit the Loan Account and credit Cash Account. Thus:

		₹	₹
Fast's Loan Account	Dr.	10,000	
To Cash Account			10,000
(Repayment of Fast's Loan)			

VIII. Any **reserve** of accumulated profit or loss lying in the books (as shown by the Balance Sheet) should be transferred to the Capital Account in the profit sharing ratio. Thus:

		₹	₹
General Reserve	Dr.	10,000	
To Fast's Capital Account			6,000
To Quick's Capital Account			4,000
(General Reserve transferred to Capital Account in the ratio of 3:2)			

IX. At this stage the Capital Accounts of partners will show how much amount is due to them or from them. The partner owing money to the firm will pay; Cash Account will be debited and his Capital Account credited and thus closed. Money owing to a partner will be paid to him; his Capital Account will be debited and the Cash Account credited. This will close the Capital Accounts as well as the Cash Account. The entry in the above example is seen in the Capital Accounts below:

		₹	₹
Fast's Capital Account	Dr.	30,400	
Quick's Capital Account	Dr.	28,600	
To Cash Account			59,000
(Amount paid to partners on Capital Account)			

Ledger Accounts

Plant and Machinery Account

2012		₹	2012		₹
Jan. 1	To Balance b/d	40,000	Jan. 1	By Realisation A/c - Transfer	40,000

Patents Accounts

2012		₹	2012		₹
Jan. 1	To Balance b/d	6,000	Jan. 1	By Realisation A/c - Transfer	6,000

Stock Account

2012		₹	2012		₹
Jan. 1	To Balance b/d	25,000	Jan. 1	By Realisation A/c - Transfer	25,000

Sundry Debtors Account

2012		₹	2012		₹
Jan. 1	To Balance b/d	19,000	Jan. 1	By Realisation A/c - Transfer	19,000

Provision for Doubtful Debts Account

2012		₹	2012		₹
Jan. 1	To Realisation A/c Transfer	1,000	Jan. 1	By Balance b/d	1,000

Sundry Creditors Account

2012		₹	2012		₹
Jan. 1	To Realisation A/c Transfer	20,000	Jan. 1	By Balance b/d	20,000

Fast's Loan Account

2012		₹	2012		₹
Jan. 1	To Cash Account	10,000	Jan. 1	By Balance b/d	10,000

General Reserve Account

2012		₹		2012		₹
Jan. 1	To Capital Accounts			Jan. 1	By Balance b/d	10,000
	Fast	6,000				
	Quick	4,000	10,000			
			10,000			10,000

Realisation Account

2012		₹	2012			₹
Jan.	To Sundry Assets		Jan.	By Sundry Creditors		20,000
	Plant and Machinery	40,000		By Provision for Doubtful Debts		1,000
	Patents	6,000		By Cash Account-		85,500
	Stock	25,000		assets realised		
	Sundry Debtors	19,000		By Fast's Capital Account- patents		
	To Cash Account- Exp.	3,500		taken over		5,000
	To Cash Account-			By Loss to :		
	Creditors paid	19,000		Fast	600	
				Quick	400	1,000
		1,12,500				1,12,500

Cash Account

2012		₹		2012	₹
Jan. 1	To Balance b/d	6,000	Jan. 1	By Realisation A/c-Exp.	3,500
	To Realisation b/d	85,500	Jan. 1	By Realisation A/c-Creditors	19,000
			Jan. 1	By Fast's Loan Account	10,000
			Jan. 1	By Fast's Capital A/c	30,400
			Jan. 1	By Quick's Capital A/c	28,600
		91,500			91,500

Fast's Capital Account

2012		₹	2012		₹
Jan. 1	To Realisation A/c- Patents	5,000	Jan. 1	By Balance b/d	30,000
	To Realisation A/c-Loss	600	Jan. 1	By General Reserve	6,000
	To Cash Account	30,400			
		36,000			36,000

Quick's Capital Account

2012		₹	2012		₹
Jan. 1	To Realisation A/c-loss	400	Jan. 1	By Balance b/d	25,000
	To Cash Account	28,600		By General Reserve	4,000
		29,000			29,000

Note :

(1) If any of the assets is taken over by a partner at a value mutually agreed to by the partners,

debit the Partner's Capital Account and credit Realisation Account with the price of asset taken over.

(2) Pay off the liabilities, crediting cash and debiting the liability accounts, the difference between the book figure and the amount paid being transferred to the Realisation Account.

(3) Liabilities to outsiders may also be transferred to the Realisation Account. In that case, the amount paid in respect of the liabilities in cash should be debited to the Realisation Account, Cash Account being credited. If liability is taken over by a partner, Realisation Account should be debited and the Partners' Capital A/cs credited at the figure agreed upon.

(4) The balance of the Realisation Account will represent either the profit or loss on realisation. Divide it between the partners in the proportion in which they shared profits and losses. In the case of a loss, credit Realisation Account and debit various partners' Capital Accounts; follow the opposite course in the case of a profit.

(5) Pay off the partners' loans or advances which are separate from the capital (if any) contributed by them, after setting off against them any debit balance in the capital account of the concerned partner.

(6) The balance of the cash account at the end will be exactly equal to the balance of capital account, provided they are in credit; credit cash and debit the partners' capital account with the amount payable to them to close their accounts.

If the capital account of a partner is in debit, after his share of loss or profit has been adjusted therein, the firm will not have sufficient cash or assets to pay off the amounts due to the other partners, until the amount is repaid by the partner whose account is in debit. If however, the partner is insolvent, the amount will not be realised. In such a case, the deficiency may be borne by the solvent partners in their profit-sharing ratio or according to the principle settled in the well known case of *Garner* vs. *Murray*. In the latter case, the deficiency would be borne by the solvent partners in proportion to their capitals and not in the proportion in which they share profits and losses.

1.5 Consequences of Insolvency of a Partner

If a partner goes insolvent then the following are the consequences:

1. The partner adjudicated as insolvent ceases to be a partner.
2. He ceases to be a partner on the date on which the order of adjudication is made.
3. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
4. The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and
5. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.

1.6 Loss Arising from Insolvency of a Partner

When a partner is unable to pay his debt due to the firm he is said to be insolvent and the share of loss is to be borne by other solvent partners in accordance with the decision in the English case of Garner vs. Murray.

According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realisation of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

The determination of capital ratio for this has been explained below. The provisions of the Indian Partnership Act are not contrary to Garner vs. Murray rule. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per deed should be applied.

Capital Ratio on Insolvency

- The partners are free to have either fixed or fluctuating capitals in the firm.
- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business shall not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.
- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances it is better not to transfer the amount of creditors to Realisation Account.
- Creditors may be paid the amount available including the amount contributed by the partners.
- The unsatisfied portion of creditor account is transferred to Capital Accounts of the partners in the profit sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

Illustration 1

P, Q and R were partners sharing profits and losses in the ratio of 3 : 2 : 1, no partnership salary or interest on capital being allowed. Their balance sheet on 30th June, 2012 is as follows:

Liabilities		₹	Assets		₹
Fixed Capital			Fixed assets :		
P	20,000		Goodwill		40,000
Q	20,000		Freehold Property		8,000
R	10,000	50,000	Plant and Equipment		12,800
Current Accounts :			Motor Vehicle		700
P	500		Current Assets		
Q	9,000	9,500	Stock		3,900
Loan from P		8,000	Trade Debtors	2,000	
Trade Creditors		12,400	Less : Provision	(100)	1,900
			Cash at Bank		200
			Miscellaneous losses		
			R's Current Account		400
			Profit and Loss Account		12,000
		79,900			79,900

On 1st July, 2012 the partnership was dissolved. Motor Vehicle was taken over by Q at a value of ₹ 500 but no cash passed specifically in respect of this transaction. Sale of other assets realised the following amounts:

	₹
Goodwill	nil
Freehold Property	7,000
Plant and Equipment	5,000
Stock	3,000
Trade Debtors	1,600

Trade Creditors were paid ₹ 11,700 in full settlement of their debts. The costs of dissolution amounted to ₹ 1,500. The loan from P was repaid, P and Q were both fully solvent and able to bring in any cash required but R was forced into bankruptcy and was only able to bring 1/3 of the amount due.

You are required to show:

(a) Cash and Bank Account,

(b) Realisation Account, and

(c) Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

Solution

Cash / Bank Account

		₹		₹
To Balance b/d		200	By Realisation A/c-Creditors	11,700
To Realisation A/c-			By Realisation A/c-Expenses	1,500
Freehold property		7,000	By P's Loan A/c	8,000
Plant and Equipment		5,000	By P's Capital A/c	14,200
Stock		3,000	By Q's Capital A/c	24,200
Trade Debtors		1,600		
To Capital Accounts:				
P	25,500			
Q	17,000			
R	300	42,800		
		59,600		59,600

Realisation Account

	₹			₹
To Goodwill	40,000	By Trade Creditors		12,400
To Freehold Property	8,000	By Provision for Bad Debts		100
To Plant and Equipment	12,800	By Bank :		
To Motor Vehicle	700	Freehold Property	7,000	
To Stock	3,900	Plant and Equip.	5,000	
To Sundry Debtors	2,000	Stock	3,000	
To Bank (Creditors)	11,700	Debtors	1,600	16,600
To Bank (Expenses)	1,500	By Q (Car)		500
		By Capital Accounts: (Loss)		
		P	25,500	
		Q	17,000	
		R	8,500	51,000
	80,600			80,600

Partners' Capital Accounts

	P ₹	Q ₹	R ₹		P ₹	Q ₹	R ₹
To Current A/c (Transfer)	5,500*	—	2,400**	By Balance b/d	20,000	20,000	10,000
To Realisation A/c (Loss)	25,500	17,000	8,500	By Current A/c (Transfer)	—	5,000***	—
To Realisation A/c (Car)	—	500	—	By Bank	-	—	300
				By Bank (realization loss)	25,500	17,000	-
To R's Capital A/c (Deficiency)	300	300	—				
To Bank	14,200	24,200	—	By P & Q (Deficiency)	—	—	600
	45,500	42,000	10,900		45,500	42,000	10,900

Note:

1. P, Q and S will bring cash to make good their share of the loss on realization. In actual practice they will not be bringing any cash; only a notional entry will be made.
2. On following Garner Vs. Murray rule, solvent partners P and Q have to bear the loss due to insolvency of a partner R in their fixed capital ratio.

Illustration 2

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 2012 when the firm was dissolved:

	₹		₹
Creditors A/c	*4,800*	*Plant & Machinery*	*2,500*
Amal's Capital A/c	*750*	*Furniture*	*500*
		Debtors	*1,000*
		Stock	*800*
		Cash	*200*
		Bimal's drawings	*550*
	5,550		*5,550*

Current account balances have been arrived after adjusting profit and loss account debit balance as follows:

* ₹ 6,000 - ₹ 500 = ₹ 5,500

** ₹ 2,000 + ₹ 400 = ₹ 2,400

*** ₹ 9,000 - ₹ 4,000 = ₹ 5,000

The assets realised as under:

	₹
Plant & Machinery	*1,250*
Furniture	*150*
Debtors	*400*
Stock	*500*

The expenses of realisation amounted to ₹ 175. Amal's private estate is not sufficient even to pay his private debts, whereas Bimal's private estate has a surplus of ₹ 200 only.

Show necessary ledger accounts to close the books of the firm.

Solution

In the books of M/s Amal and Bimal

Realisation Account

	₹			₹
To Sundry Assets :		By Cash A/c :		
Plant & Machinery	2,500	Plant & Machinery	1,250	
Furniture	500	Furniture	150	
Debtors	1,000	Debtors	400	
Stock	800	Stock	500	2,300
Cash A/c-expenses	175	By Partners' Capital A/c		
		Loss on realisation (Bal.fig.)		
		Amal	1,337	
		Bimal	1,338	2,675
	4,975			4,975

Cash Account

	₹		₹
March 31, 2012		March 31, 2012	
To Balance b/d	200	By Realisation A/c- expenses	175
To Realisation A/c		By Sundry Creditors A/c (Bal.fig.)	2,525
- Sale of sundry assets	2,300		
To Bimal's Capital A/c	200		
	2,700		2,700

Sundry Creditors Account

	₹		₹
To Cash A/c	2,525	By Balance b/d	4,800
To Deficiency A/c-transfer (bal.fig.)	2,275		
	4,800		4,800

Partners' Capital Account

	Amal ₹	Bimal ₹		Amal ₹	Bimal ₹
To Balance b/f	—	550	By Balance b/f	750	—
To Realisation A/c			By Cash A/c	—	200
- loss	1,337	1,338	By Deficiency		
			A/c- transfer (bal.fig.)	587	1,688
	1,337	1,888		1,337	1,888

Deficiency Account

	₹		₹
To Partners' Capital A/c		By Sundry Creditors A/c	2,275
Amal	587		
Bimal	1,688		
	2,275		2,275

Illustration 3

A, B, C and D sharing profits in the ratio of 4:3:2:1 decided to dissolve their partnership on 31st March 2012 when their balance sheet was as under:

Liabilities		*₹*	*Assets*	*₹*
Creditors		*15,700*	*Bank*	*535*
Employees Provident Fund		*6,300*	*Debtors*	*15,850*
Capital Accounts :-			*Stock*	*25,200*
A	*40,000*		*Prepaid Expenses*	*800*
B	*20,000*	*60,000*	*Plant & Machinery*	*20,000*
			Patents	*8,000*
			C's Capital A/c	*3,200*
			D's Capital A/c	*8,415*
		82,000		*82,000*

Following information is given to you :-

1. *One of the creditors took some of the patents whose book value was ₹ 5,000 at a valuation of ₹ 3,200. Balance of the creditors were paid at a discount of ₹ 400.*

2 *There was a joint life policy of ₹ 20,000 (not mentioned in the balance sheet) and this was surrendered for ₹ 4,500.*

3 *The remaining assets were realised at the following values:- Debtors ₹ 10,800; Stock ₹ 15,600; Plant and Machinery ₹ 12,000; and Patents at 60% of their book-values. Expenses of realisation amounted ₹ 1,500.*

D became insolvent and a dividend of 25 paise in a rupee was received in respect of the firms claim against his estate. Prepare necessary ledger accounts.

Solution

Realisation Account

		₹			₹
To Sundry Assets :-			By Creditors		15,700
Debtors	15,850		By Employee's Provident Fund		6,300
Stock	25,200		By Bank A/c :-		
Prepaid Expenses	800		Joint Life Policy	4,500	
Plant & Machinery	20,000		Debtors	10,800	
Patents	8,000	69,850	Stock	15,600	
To Bank-Creditors: (₹ 15,700 – ₹ 3,200-₹ 400)		12,100	Plant and Machinery	12,000	
To Bank A/c Employee's (P.F)		6,300	Patents 60% of (₹ 8,000 – ₹ 5,000)	1,800	44,700
To Bank A/c (expenses)		1,500	By Loss transferred to :-		
			A's Capital A/c	9,220	
			B's Capital A/c	6,915	
			C's Capital A/c	4,610	
			D's Capital A/c	2,305	23,050
		89,750			89,750

Capital Accounts

	A ₹	B ₹	C ₹	D ₹		A ₹	B ₹	C ₹	D ₹
To Bal. b/d	—	—	3,200	8,415	By Bal. b/d	40,000	20,000	—	—
To Realisation A/c	9,220	6,915	4,610	2,305	By Bank (Realisation loss)	9,220	6,915	4,610	—
To D's Capital (Deficiency)	5,360	2,680	—	—	By Bank (Recovery)	—	—	—	2,680
To Bank	34,640	17,320	—	—	By A's Capital 2/3	—	—	—	5,360
					By B's Capital 1/3	—	—	—	2,680
					By Bank A/c		—	3,200	—
	49,220	26,915	7,810	10,720		49,220	26,915	7,810	10,720

Bank Account

	₹		₹
To Balance b/d	535	By Realisation A/c	12,100
To Realisation A/c	44,700	By Realisation A/c	6,300
To A's Capital A/c	9,220	By Realisation A/c	1,500
To B's Capital A/c	6,915	By A's Capital A/c	34,640
To D's Capital A/c	2,680	By B's Capital A/c	17,320
To C's Capital A/c (4,610 + 3,200)	7,810		
	71,860		71,860

Working Note :-

D's loss will be borne by A and B only as solvent partners having credit balance only has to bear the loss on account of insolvency. C will bring his share of loss in cash.

Illustration 4

M/s X, Y and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as at December 31, 2012:

Liabilities	*₹*	*₹*	*Assets*	*₹*	*₹*
Capital : X	*29,200*		*Fixed Assets*		*40,000*
Y	*10,800*		*Stock*		*25,000*
Z	*10,000*	*50,000*	*Book Debts*	*25,000*	
Z's Loan		*5,000*	*Less : Provision*	*(5,000)*	*20,000*
Loan from Mrs. X		*10,000*	*Cash*		*1,000*
Sundry Trade Creditors		*25,000*	*Advance to Y*		*4,000*
		90,000			*90,000*

The firm was dissolved on the date mentioned above due to continued losses. After drawing up the balance sheet given above, it was discovered that goods amounting to ₹ 4,000 have been purchased in November, 2012 and had been received but the purchase was not recorded in books.

Fixed assets realised ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on the average. The expenses of realisation come to ₹ 1,080. X agreed to take over the loan of Mrs. X. Y is insolvent, and his estate is unable to contribute anything.

Give accounts to close the books; work according to the decision in Garner vs. Murray.

Solution

Realisation Account

	₹			₹
To Sundry		By Provision for Doubtful Debts		5,000
Fixed Assets (transfer)	40,000	By Cash (20,000+21,000+20,500)		61,500
Stock	25,000	By Sundry Trade Creditors		
Book Debts	25,000	(Discount)		580
To Cash—Expenses	1,080	By Loss :X (2/5)	9,600	
		Y (2/5)	9,600	
		Z (1/5)	4,800	24,000
	91,080			91,080

Sundry Trade Creditors

	₹		₹
To Realisation A/c – Discount		By Balance b/d	25,000
@ 2% on ₹ 29,000	580	By Sundry Capital Accounts	
To Cash	28,420	(Purchase omitted)	4,000
	29,000		29,000

Z's Loan Account

	₹		₹
To Cash Account	5,000	By Balance b/d	5,000

Mrs. X's Loan Account

	₹		₹
To X's Capital A/c - transfer	10,000	By Balance b/d	10,000

Cash Account

	₹		₹
To Balance b/d	1,000	By Sundry Trade Creditors	28,420
To Realisation A/c-		By Realisation A/c - expenses	1,080
assets realised	61,500	By Z's Loan	5,000
To X's Capital A/c*	9,600	By X's Capital A/c	34,300

To Z's Capital A/c*	4,800	By Z's Capital A/c	8,100
	76,900		76,900

*X and Z bring these amounts to make good their share of the loss on realisation. In actual practice they will not be bringing any cash; only a notional entry will be made.

Capital Accounts

	X ₹	Y ₹	Z ₹		X ₹	Y ₹	Z ₹
To Sundry Trade Creditors-omission	1,600	1,600	800	By Balance b/d	29,200	10,800	10,000
To Balance c/d	27,600	9,200	9,200				
	29,200	10,800	10,000		29,200	10,800	10,000
To Advance	-	4,000	-	By Balance b/d	27,600	9,200	9,200
To Realisation A/c-loss	9,600	9,600	4,800	By Mrs. X's Loan	10,000	-	-
To Y's Capital A/c	3,300	-	1,100	By Cash (Realisation loss)	9,600	-	4,800
				By X's Capital A/c-		3,300	
To Cash	34,300	-	8,100	By Z's Capital A/c	-	1,100	-
	47,200	13,600	14,000		47,200	13,600	14,000

Note : Y's deficiency comes to ₹ 4,400 (difference in the two sides of his Capital Account); this has been debited to X and Z in the ratio of 27,600 : 9,200 *i.e.,* capital standing up just before dissolution but after correction of error committed while drawing up the accounts for 2012.

Illustration 5

'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1.

On 30th September, 2012 their Balance Sheet was as follows :

Liabilities		*₹*	*Assets*	*₹*
Capital Accounts :			*Premises*	*50,000*
Thin	*80,000*		*Fixtures*	*1,25,000*
Short	*50,000*		*Plant*	*32,500*
Fat	*20,000*	*1,50,000*	*Stock*	*43,200*
Current Accounts :			*Debtors*	*54,780*
Thin	*29,700*			
Short	*11,300*			
Fat (Dr.)	*(14,500)*	*26,500*		
Sundry Creditors		*84,650*		
Bank Overdraft		*44,330*		
		3,05,480		*3,05,480*

'Thin' decides to retire on 30th September, 2012 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so all three partners decide to dissolve the partnership with effect from 30th September, 2012. It then transpires that 'Fat' has no private assets whatsoever.

The premises are sold for ₹ 60,000 and the plant for ₹ 1,07,500. The fixtures realize ₹ 20,000 and the stock is acquired by another firm at book value less 5%. Debtors realise ₹ 45,900. Realisation expenses amount to ₹ 4,500.

The bank overdraft is discharged and the creditors are also paid in full.

You are required to write up the following ledger accounts in the partnership books following the rules in Garner vs. Murray:

(i) Realisation Account;

(ii) Partners' Current Accounts;

(iii) Partners' Capital Accounts showing the closing of the firm's books.

Solution

Realisation Account

	₹			₹
To Premises	50,000	By Sundry Creditors		84,650
To Plant	1,25,000	By Bank :		
To Fixtures	32,500	Premises	60,000	
To Stock	43,200	Plant	1,07,500	
To Debtors	54,780	Fixtures	20,000	
To Bank (Creditors)	84,650	Stock	41,040	
To Bank (Expenses)	4,500	Debtors	45,900	2,74,440
		By Loss on Realisation transferred to Partners' Current A/cs		
		Thin	14,216	
		Short	14,216	
		Fat	7,108	35,540
	3,94,630			3,94,630

Partners' Current Accounts

	Thin	*Short*	*Fat*		*Thin*	*Short*	*Fat*
	₹	₹	₹		₹	₹	₹
To Balance b/d	–	–	14,500	By Balance b/d	29,700	11,300	–
To Realisation	14,216	14,216	7,108	By Capital A/c			
To Capital A/c				Transfer	–	2,916	21,608

transfer	15,484	–	–				
	29,700	14,216	21,608		29,700	14,216	21,608

Partners' Capital Accounts

	Thin	*Short*	*Fat*		*Thin*	*Short*	*Fat*
	₹	₹	₹		₹	₹	₹
To Current A/c	–	2,916	21,608	By Balance b/d	80,000	50,000	20,000
To Fat's Capital A/c				By Current A/c			
Deficiency in the				(transfer)	15,484	–	–
ratio of 8:5	990	618	–	By Bank (Realisation loss)	14,216	14,216	
To Bank	1,08,710	60,682	–	By Thin & Short			
				Capital A/cs			1,608
	1,09,700	64,216	21,608		1,09,700	64,216	21,608

Working Notes:

(i) **Bank Account**

	₹		₹
To Realisation A/c	2,74,440	By Balance b/d	44,330
To Thin's Capital A/c	14,216	By Realisation A/c (Creditors)	84,650
To Short's Capital A/c	14,216	By Realisation A/c (Expenses)	4,500
		By Thin's Capital A/c	1,08,710
		By Short's Capital A/c	60,682
	3,02,872		3,02,872

(ii) Fat's deficiency has been by borne Thin & Short in the ratio of their fixed capitals i.e., 8:5 following the rule in *Garner vs. Murray.*

1.7 Piecemeal Payments

Generally, the assets sold upon dissolution of partnership are realised only in small instalments over a period of time. In such circumstances, the choice is either to distribute whatever is collected or to wait till the whole amount is collected. Usually, the first course is adopted. In order to ensure that the distribution of cash among the partners is in proportion to their interest in the partnership concern either of the two methods described below may be followed for determining the order in which the payment should be made.

1.7.1 Maximum Loss Method

Each instalment realised is considered to be the final payment *i.e.,* outstanding assets and claims are considered worthless and partners' accounts are adjusted on that basis each time when a distribution is made, following either *Garner* vs. *Murray* Rule or the profit-sharing ratio rule.

Illustration 6

The following is the Balance Sheet of A, B, C on 31st December, 2012 when they decided to dissolve the partnership:

Liabilities	*₹*	*Assets*	*₹*
Creditors	*2,000*	*Sundry Assets*	*48,500*
A's Loan	*5,000*	*Cash*	*500*
Capital Accounts :			
A	*15,000*		
B	*18,000*		
C	*9,000*		
	49,000		*49,000*

The assets realised the following sums in instalments:

I	*1,000*
II	*3,000*
III	*3,900*
IV	*6,000*
V	*20,100*
	34,000

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only.

Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1.

Solution

First of all, the following table will be constructed to show the amounts available for distribution among the various interests:

Statement showing Realisation and Distribution of Cash Payments

	Realisation ₹	*Creditors* ₹	*Partners' Loan* ₹	*Partners' Capitals* ₹
1. After taking into account	1,000	1,000	-	-

	cash balance and amount set aside for expenses				
2.		3,000	1,000	2,000	-
3.		3,900	-	3,000	900
4.		6,000	-	-	6,000
	Including saving in expenses	20,100	-	-	20,100
		34,000	2,000	5,000	27,000

To ascertain the amount distributable out of each instalment realised among the partners, the following table will be constructed:

Statement of Distribution on Capital Account

(1) Calculation to determine the mode of distribution of ₹ 900

	Total ₹	*A* ₹	*B* ₹	*C* ₹
Balance	42,000	15,000	18,000	9,000
Less: Possible loss, should remaining assets prove to be worthless	(41,100)	(16,440)	(16,440)	(8,220)
	+ 900	– 1,440	+ 1,560	+ 780
Deficiency of A's capital written off against those of B and C in the ratio of their capital, 18,000 : 9,000 (*Garner* vs. *Murray*)			(960)	(480)
Manner in which the first ₹ 900 should be distributed			+ 600	+ 300

(2) *Distribution of ₹ 6,000*

Balance after making payment of amount shown in step (1)	41,100	15,000	17,400	8,700
Less : Possible Loss assuming remaining asset to be valueless	(35,100)	(14,040)	(14,040)	(7,020)
Balance available and to be distributed	6,000	960	3,360	1,680

(3) *Distribution of ₹ 20,100*

Balance after making payment of				

amount shown in step (2)	35,100	14,040	14,040	7,020
Less : Possible loss, assuming remaining				
assets to be valueless	(15,000)	(6,000)	(6,000)	(3,000)
Manner of distribution of ₹ 20,100	20,100	8,040	8,040	4,020
Summary :				
Balance	42,000	15,000	18,000	9,000
Total amounts paid	27,000	9,000	12,000	6,000
Loss	15,000	6,000	6,000	3,000

1.7.2 Highest Relative Capital Method

According to this method, the partner who has the higher relative capital, that is, whose capital is greater in proportion to his profit-sharing ratio, is first paid off. This method is also called as proportionate capital method.

For determining the amount by which the capital of each partner is in excess of his relative capital, partners' capitals are first divided by figures that are in proportion to their profit-sharing ratio; the smallest quotient will indicate the basic capital. Having ascertained the partner who has the smallest basic capital, the amount of capital of other partners proportionate to the profit-sharing ratio of the basic capital is calculated. These may be called as their hypothetical capitals. The amount of hypothetical capital of each partner is then subtracted from the amount of his actual capital; the resultant figure will be the amount of excess capital held by him. By repeating the process once or twice, as may be necessary between the partners having excess capital, the amount by which the capital of each partner is in excess will be ascertained. The partner with the largest excess capital will be paid off first, followed by payment to the other or others who rank next to him until the capitals of partners are reduced to their profit-sharing ratio.

The illustration given above is now worked out according to this method.

	A	*B*	*C*
Capital	₹ 15,000	18,000	9,000
Profit-sharing ratio	2	2	1
Capital divided by the profit-sharing ratio	7,500	9,000	9,000
Proportionate Capital of B and C, taking			
A's capital as the base	₹ 15,000	15,000	7,500
Excess of actual over proportionate capital	₹ nil	3,000	1,500

This indicates that A should not get anything till ₹ 3,000 is paid to B and ₹ 1,500 is paid to C. Since capital of B and C are already according to their mutual profit-sharing ratio (2:1), they will share the available cash in this ratio.

After paying off creditors and A's loan, the available amount will be distributed as below in this method:

	Total	*A* ₹	*B* ₹	*C* ₹
Third Instalment	900	-	600	300
Fourth Instalment (*i*)	3,600	-	2,400	1,200
(*ii*)	2,400	960	960	480
Fifth Instalment	20,100	8,040	8,040	4,020
Total	27,000	9,000	12,000	6,000

Total payment made to each partner will, of course be same under both the methods.

Illustration 7

The partners A, B and C have called you to assist them in winding up the affairs of their partnership on 30th June, 2012. Their Balance Sheet as on that date is given below :

Liabilities	*₹*	*Assets*	*₹*
Sundry Creditors	*17,000*	*Cash at Bank*	*6,000*
Capital Accounts :		*Sundry Debtors*	*22,000*
A	*67,000*	*Stock in trade*	*14,000*
B	*45,000*	*Plant and Equipment*	*99,000*
C	*31,500*	*Loan-A*	*12,000*
		Loan-B	*7,500*
	1,60,500		*1,60,500*

(1) The partners share profit and losses in the ratio of 5:3:2

(2) Cash is distributed to the partners at the end of each month

(3) A summary of liquidation transactions are as follows:

July 2012

₹ 16,500 – collected from Debtors; balance is uncollectable.

₹ 10,000 – received from sale of entire stock.

₹ 1,000 – liquidation expenses paid.

₹ 8,000 – cash retained in the business at the end of the month.

August 2012

₹ 1,500 – liquidation expenses paid. As part payment of his Capital, C accepted a piece of equipment for ₹ 10,000 (book value ₹ 4,000).

₹ 2,500 – cash retained in the business at the end of the month.

September 2012

₹ 75,000 – received on sale of remaining plant and equipment.

₹ 1,000 – liquidation expenses paid. No cash retained in the business.

Required : Prepare a schedule of cash payments as of September 30, showing how the cash was distributed.

Solution

Statement showing distribution of cash

		Creditors	*Capitals*		
	₹	₹	*A (₹)*	*B (₹)*	*C (₹)*
Balance Due after loan (W.N.(i))		17,000	55,000	37,500	31,500
July					
Balance available	6,000				
Realisation less expenses					
and cash retained	17,500				
Amount available and paid	23,500	17,000	-	-	6,500
Balance due		—	55,000	37,500	25,000
August					
Opening balance	8,000				
Expenses paid and					
balance carried forward	4,000				
Available for distribution	4,000				
Cash paid to 'B' and Equipment					
given to C.			—	4,000	10,000
(Excess paid to 'C' ₹ 7,333)			55,000	33,500	15,000
September					
Opening balance	2,500				
Amount realised less expenses	74,000				
Amount paid to partners	76,500		41,500	25,400	9,600
			13,500	8,100	5,400

Working Note:

(i) **Highest Relative Capital Basis**

		A ₹	B ₹	C ₹
Scheme of payment for July				
Balance of Capital Accounts		67,000	45,000	31,500
Less : Loans		(12,000)	(7,500)	—
	A	55,000	37,500	31,500
Profit sharing ratio		5	3	2
Capital Profit sharing ratio		11,000	12,500	15,750
Capital in profit sharing ratio, taking A's capital as base	B	55,000	33,000	22,000
Excess of C's Capital and B's Capital (A-B)			4,500	9,500
Profit sharing ratio			3	2
Capital Profit sharing ratio			1,500	4,750
Capital in profit sharing ratio taking B's Capital as base			4,500	3,000
Excess of C's Capital over B				6,500

(ii) **Scheme of distribution of available cash:**

	A	*B*	*C*
	₹	₹	₹
Scheme of payment for September			
Balance of Capital Accounts ***(A)***	55,000	33,500	15,000
Profit sharing ratio	5	3	2
Capital/Profit sharing ratio	11,000	11,167	7,500
Capital in profit sharing ratio taking C's capital as base ***(B)***	37,500	22,500	15,000
Excess of A's capital and B's capital ***(A-B)***	17,500	11,000	-
Profit sharing ratio	5	3	
Capital in profit sharing ratio	3,500	3,667	
Capital in profit sharing ratio taking A's capital as base	17,500	10,500	-
Excess of B's capital over A's capital	–	500	–

Payment ₹ 500	***(C)***	-	(500)	-
Balance of Excess		17,500	10,500	
Payment ₹ 28,000	***(D)***	(17,500)	(10,500)	-
Balance ***[A-C-D]***		37,500	22,500	15,000
Payment (₹ 76,500 – ₹ 28,500) ₹ 48,000	***(D)***	(24,000)	(14,400)	(9,600)
Loss		13,500	8,100	5,400
Total Payment ₹ 76,500 ***[A+C+D]***		41,500	25,400	9,600

Illustration 8

The firm of LMS was dissolved on 31.3.2012, at which date its Balance Sheet stood as follows:

Liabilities	*₹*	*Assets*	*₹*
Creditors	*2,00,000*	*Fixed Assets*	*45,00,000*
Bank Loan	*5,00,000*	*Cash and Bank*	*2,00,000*
L's Loan	*10,00,000*		
Capital			
L	*15,00,000*		
M	*10,00,000*		
S	*5,00,000*		
	47,00,000		*47,00,000*

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are:

S.No.	*Amount in ₹*
1	*5,00,000 (including cash and bank*
2	*15,00,000*
3	*15,00,000*
4	*30,00,000*
5	*30,00,000*

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

Solution

In the Books of M/s LMS
Statement of Piecemeal Distribution (Under Higher Relative Capital method)

Particulars	*Amount Available* ₹	*Creditors* ₹	*Bank Loan* ₹	*L's loan* ₹	*Capital A/cs* L ₹	M ₹	S ₹
Balance due		2,00,000	5,00,000	10,00,000	15,00,000	10,00,000	5,00,000
1st Instalment (including cash and bank balances)	5,00,000						
Less: Liquidator's Expenses and fee	(1,00,000)						
	4,00,000						
Less: Payment to Creditors and repayment of Bank Loan in the ratio of 2:5	(4,00,000)	(1,14,286)	(2,85,714)	–	–	–	–
Balance Due	–	85,714	2,14,286	10,00,000	15,00,000	10,00,000	5,00,000
2nd Instalment	15,00,000						
Less: Payment to Creditors and repayment of bank loan in full settlement	(3,00,000)	(85,714)	(2,14,286)	–	–	–	–
Balance Due	12,00,000	Nil	Nil	10,00,000	15,00,000	10,00,000	5,00,000
Less: Repayment of L's Loan	(10,00,000)			(10,00,000)	–	–	–
Balance Due	2,00,000			-	15,00,000	10,00,000	5,00,000
Less: Payment to Mr. L towards relative higher capital (W.N. 1)	(2,00,000)				(2,00,000)	–	–
Balance Due	Nil			Nil	13,00,000	10,00,000	5,00,000
3rd Instalment	15,00,000						
Less: Payment to Mr. L towards higher relative capital (W.N. 2)	(3,00,000)				(3,00,000)	–	–

Balance Due	12,00,000				10,00,000	10,00,000	5,00,000
Less: Payment to Mr. L & Mr. M towards excess capital (W.N. 1&2)	(10,00,000)				(5,00,000)	(5,00,000)	–
Balance Due	2,00,000				5,00,000	5,00,000	5,00,000
Less: Payment to all the partners equally	(2,00,000)				(66,667)	(66,667)	(66,666)
Balance due	Nil				4,33,333	4,33,333	4,33,334
4th Instalment	30,00,000						
Less: Payment to all the partners equally	(30,00,000)				(10,00,000)	(10,00,000)	(10,00,000)
Realisation profit credited to Partners					5,66,667	5,66,667	5,66,666
5th Instalment	30,00,000						
Less: payment to all partners equally	(30,00,000)				10,00,000	10,00,000	10,00,000
Realisation profit credited to partners					15,66,667	15,66,667	15,66,666

Working Notes:

(i) Scheme of payment of surplus amount of ₹ 2,00,000 out of second Instalment:

	Capital A/cs		
	L ₹	*M* ₹	*S* ₹
Balance (i)	15,00,000	10,00,000	5,00,000
Profit sharing ratio (ii)	1	1	1
Capital taking S's Capital (iii)	5,00,000	5,00,000	5,00,000
Excess Capital (iv) = (i) – (iii)	10,00,000	5,00,000	
Profit Sharing Ratio	1	1	
Excess capital taking			
M's Excess Capital as base (v)	5,00,000	5,00,000	
Higher Relative Excess (iv) – (iv)	5,00,000		

So, Mr. L should get ₹ 5,00,000 first which will bring down his capital account balance from ₹ 15,00,000 to ₹ 10,00,000. Accordingly, surplus amounting to ₹ 2,00,000 will be paid to Mr. L towards higher relative capital.

(ii) Scheme of payment of ₹ 15,00,000 realised in 3rd Instalment:

- Payment of ₹ 3,00,000 will be made to Mr. L to discharge higher relative capital. This makes the higher capital of both Mr. L and Mr. M ₹ 5,00,000 as compared to capital of Mr. S.
- Payment of ₹ 5,00,000 each of Mr. L & Mr. M to discharge the higher capital.
- Balance ₹ 2,00,000 equally to L, M and S, i.e., ₹ 66,667 ₹ 66,667 and ₹ 66,666 respectively.

Illustration 9

Daksh Associates is a reputed firm. On account of certain misunderstanding between the partners, it was decided to dissolve the firm as on 31st December, 2011. Their Balance Sheet as on 31st December, 2011 was follows:

Liabilities		*₹*	*Assets*	*₹*
Capitals:			*Land and Buildings*	*7,00,000*
Daksh	*3,00,000*		*Other Fixed Assets*	*3,00,000*
Yash	*2,00,000*		*Stock in Trade*	*2,00,000*
Siddhart (Minor)	*1,00,000*		*Debtors*	*4,00,000*
		6,00,000	*Bills Receivable*	*1,50,000*
Trade Loans		*3,00,000*	*Goodwill*	*30,000*
Bank Overdraft		*3,00,000*	*Cash*	*20,000*
Other Loans		*2,00,000*		
Creditors		*2,00,000*		
Siddhart's Loan		*2,00,000*		
		18,00,000		*18,00,000*

It was decided that Mr. Daksh shall be in-charge of Realisation. He shall set apart ₹ 10,000 towards expenses. He shall be paid a remuneration of 5 percent on the amounts distributed to the partners towards their contribution other than loans. Assets realized are as under:

		₹
1-1-2012	*Debtors*	*3,50,000*
15-1-2012	*Fixed Assets*	*4,00,000*
1-2-2012	*Debtors*	*50,000*
15-2-2012	*Bills Receivable*	*1,40,000*
1-3-2012	*Fixed Assets*	*50,000*
15-3-2012	*Land and Buildings*	*8,00,000*

Prepare a statement showing how the money received on various dates will be distributed assuming:

(a) The actual expenses of realization amounted to ₹ 20,005.

(b) The firm is solvent.

(c) The profit sharing ratio was as under:

	Profit	Loss
Daksh	2	1
Yash	2	1
Siddhart	1	Nil
	5	2

(d) The final dissolution is made on 15th March, 2012

Solution

It is assumed that trade loans, bank overdraft, other loans and creditors have equal priority at the time of payment. Therefore, they all have been paid in the ratio of their dues outstanding.

Particulars		Trade Loans ₹	Bank Overdraft ₹	Other Loans ₹	Creditors ₹	Siddhart's Loan ₹	Daksh's Capital ₹	Yash's Capital ₹	Siddhart's Capital ₹
Amount due		3,00,000	3,00,000	2,00,000	2,00,000	2,00,000	3,00,000	2,00,000	1,00,000
Cash in hand	20,000								
Less: Amount kept for realization expenses	(10,000)								
	10,000								
Less: Distributed among outsiders (3:3:2:2)	(10,000)	(3,000)	(3,000)	(2,000)	(2,000)	-	-	-	-
Balance Due	Nil	2,97,000	2,97,000	1,98,000	1,98,000	2,00,000	3,00,000	2,00,000	1,00,000
Debtors realised on 1-1-2012	3,50,000								
Less: Distributed among outsiders (3:3:2:2)	(3,50,000)	(1,05,000)	(1,05,000)	(70,000)	(70,000)	-	-	-	-
Balance Due	Nil	1,92,000	1,92,000	1,28,000	1,28,000	2,00,000	3,00,000	2,00,000	1,00,000
Fixed Assets realized on 15-1-2012	4,00,000								
Less: Distributed among outsiders (3:3:2:2)	(4,00,000)	(1,20,000)	(1,20,000)	(80,000)	(80,000)	-	-	-	-
Balance Due	Nil	72,000	72,000	48,000	48,000	2,00,000	3,00,000	2,00,000	1,00,000
Debtors realized on 1-2-2012	50,000								
Less: Distributed among									

outsiders (3:3:2:2)	(50,000)	(15,000)	(15,000)	(10,000)	(10,000)	-	-	-	-
Balance Due	Nil	57,000	57,000	38,000	38,000	2,00,000	3,00,000	2,00,000	1,00,000
Bills Receivable realised on 15-2-2012	1,40,000								
Less: Distributed among outsiders (3:3:2:2)	(1,40,000)	(42,000)	(42,000)	(28,000)	(28,000)	-	-	-	-
Balance Due	Nil	15,000	15,000	10,000	10,000	2,00,000	3,00,000	2,00,000	1,00,000
Fixed Assets realized on 1-3-2012	50,000								
Less: Distributed among outsiders (3:3:2:2)	(50,000)	(15,000)	(15,000)	(10,000)	(10,000)	-	-	-	-
Balance Due	Nil	-	-	-	-	2,00,000	3,00,000	2,00,000	1,00,000
Land and Building realised on 15-3-2012	8,00,000								
Less: Additional payment of realization expenses (20,005 – 10,000)	(10,005)								
	7,89,995								
Less: Payment of Siddhart's Loan	(2,00,000)					(2,00,000)	-	-	-
Amount available for partners' Capital	5,89,995					-	3,00,000	2,00,000	1,00,000
Less: Daksh's Commission									
(i.e. $5,89,995 \times \frac{5}{105}$)									

	(28,095)								
	5,61,900								
Less: Siddhart's Capital is paid first because he will not share any loss on account of being minor partner	(1,00,000)						____	____	(1,00,000)
	4,61,900						3,00,000	2,00,000	-
Less: Paid to Daksh to make his capital equal to that of Yash	(1,00,000)						(1,00,000)	____	
	3,61,900						2,00,000	2,00,000	-
Less: Distributed equally between Daksh and Yash	(3,61,900)						(1,80,950)	(1,80,950)	
Balance Due							19,050	19,050	Nil*

*Siddhart will get 1/5 share (i.e., share of profit) of what remains after paying ₹ 19,050 to each Daksh and Yash out of the proceeds of stock-in trade. If stock does not realize any amount, then amount unpaid to Daksh and Yash will become loss on realization. Siddhart has been paid first because he is not to share any loss on realization.

1.8 Issues Related to Accounting in Limited Liability Partnerships

The Limited Liability Partnerships (LLPs) in India were introduced by Limited Liability Partnership Act, 2008 which lay down the law for the formation and regulation of Limited Liability Partnerships.

Definitions :

Section 2 of the Limited Liability Partnership (LLPs) Act, 2008 defines the following terms as:

"limited liability partnership" means a partnership formed and registered under this Act;

"limited liability partnership agreement" means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership;

"foreign limited liability partnership" means a limited liability partnership formed, incorporated or registered outside India which establishes a place of business within India.

"business" includes every trade, profession, service and occupation;

"**designated partner"** means any partner designated as such pursuant to section 7 of the Act;

"partner", in relation to a limited liability partnership, means any person who becomes a partner in the limited liability partnership in accordance with the limited liability partnership agreement;

Nature of Limited Liability Partnership

(1) A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.

(2) A limited liability partnership shall have perpetual succession.

(3) Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Non-applicability of the Indian Partnership Act, 1932

Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership.

Minimum number of partners

As per section 5 of the LLP Act, any individual or body corporate may be a partner in a limited liability partnership:

Provided that an individual shall not be capable of becoming a partner of a limited liability partnership, if-

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending

As per section 6 of the LLP Act, every limited liability partnership shall have at least two partners.

If at any time the number of partners of a limited liability partnership is reduced below two and the limited liability partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited liability partnership during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the limited liability partnership incurred during that period.

Designated partners

As per Section 7 of the LLP Act, every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India:

Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

Explanation.-For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less 182 days during the immediately preceding one year.

Subject to the provisions of sub-section (1),

(1) if the incorporation document-

  (a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or

  (b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every such partner shall be a designated partner;

(2) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

(3) An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

(4) Every limited liability partnership shall file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

(5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

Liabilities of designated partners

As per Section 8 of LLP Act, unless expressly provided otherwise in this Act, a designated partner shall be-

(a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and .

(b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

Changes in designated partners

A limited liability partnership may appoint a designated partner within thirty days of a vacancy arising for any reason and provisions of sub-section (4) and sub-section (5) of section 7 shall apply in respect of such new designated partner:

Provided that if no designated partner is appointed, or if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.

Distinction between an ordinary partnership firm and an LLP

	Key Elements	Partnerships	LLPs
1	Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
2	Registration	Optional	Compulsory with ROC
3	Creation	Created by an Agreement	Created by Law
4	Body Corporate	No	Yes
5	Separate Legal Entity	No	Yes
6	Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
7	Number of Partners	Minimum 2 and Maximum 20 (subject to 10 for banks)	Minimum 2 but no maximum limit

8	Ownership of Assets	Firm cannot own any assets. The partners own the assets of the firm	The LLP as an independent entity can own assets
9	Liability of Partners / Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets	Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.
10	Principal Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the firm only and not of other partners

Formation of LLP

Two or more persons associated for the purpose of carrying on a lawful business with a view to earn profits may subscribe their names to an incorporation document and file the same with the Registrar of the state in which the Registered Office of the LLP is to be situated, in such manner with such fees as may be prescribed along with a statement in the prescribed form made by an advocate, a company secretary or a chartered accountant or a cost accountant that all the requirements of the LLP Act 2008 and the rules made there under have been complied with.

Limitation of Liability of an LLP and its partners

- Under section 27 (3) of the LLP Act, 2008 an obligation of an LLP arising out of a contract or otherwise, shall be solely the obligation of the LLP;
- The Liabilities of an LLP shall be met out of the properties of the LLP;
- Under section 28 (1) a partner is not personally liable, directly or indirectly, for an obligation referred to in Section 27 (3) above, solely by reason of being a partner in the LLP;
- Section 27 (1) states that an LLP is not bound by anything done by a partner in dealing with a person, if:
  - The partner does not have the authority to act on behalf of the LLP in doing a particular act; and
  - The other person knows that the partner has no authority or does not know or believe him to be a partner in the LLP
- Under section 30 (1) the liability of the LLP and the partners perpetrating fraudulent dealings shall be unlimited for all or any of the debts or other liabilities of the LLP.

Financial Disclosures & Returns

Under section 34 (1) every LLP shall maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to the double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed;

Section 34 (2): Every LLP shall within six months of the end of each financial year prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year, in such form as may be prescribed, and such statement shall be signed by the designated partners of the LLP;

Section 34 (3): Every LLP shall file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner and accompanied by such fee as may be prescribed;

The accounts of an LLP must be audited in accordance with such rules as may be prescribed.

Under Section 35 (1) of the LLP Act every LLP is required to file an Annual Return which is duly authenticated with the registrar within sixty days of the closure of its financial year in such form and manner and with such fees as may be prescribed.

Assignment and Transfer of Partnership Rights

The rights of a partner to the share of profits and losses of an LLP and to receive distribution in accordance with the LLP Agreement are transferable wholly or in part;

The transfer of any right by a partner as above does not by itself cause the disassociation of the partner or a dissolution or winding up of the LLP;

Similarly the transfer of the right as above does not entitle the transferee to participate in the management or the conduct of activities of the LLP, or give access to any information concerning the transactions of the LLP.

Conversion of firm into Limited Liability Partnership

Section 55 of LLP Act: A firm may convert into a LLP in accordance with the provisions of the Act and the Second Schedule to the Act.

Section 56 of LLP Act: A private limited company may convert into an LLP in accordance with the provisions of the Act and the Third Schedule to the Act.

Section 57 of LLP Act: An unlisted public limited company may convert into an LLP in accordance with the provisions of the Act and the Fourth Schedule to the Act.

Winding up and Dissolution

- Under section 63 of the LLP Act, 2008 an LLP may be wound up voluntarily or by the Tribunal and such LLP so wound up may be dissolved
- Under section 64 and LLP may be wound up by the Tribunal:

- If the LLP decides that it should be wound up by the Tribunal;
- If for a period of more than six months, the number of partners of the LLP is reduced below two;
- If the LLP is unable to pay its debts;
- If the LLP has acted against the interests of the integrity and sovereignty of India, the security of the state or public order;
- If the LLP has defaulted in the filing of the Statement of Account and Solvency with the Registrar for five consecutive financial years;
- If the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

Summary

- Reasons for which a partnership could be dissolved are
  - expiry of term for which its was formed
  - death of a partner
  - insolvency of a partner
  - retirement of a partner.
- Reasons when a firm stands dissolved
  - when partners mutually decide to dissolve
  - partners except one becomes insolvent
  - business becomes illegal
  - if partnership is at will any partner can give notice for dissolution
  - Court orders.
- On dissolution assets are realized and all liabilities are paid off

  (*if any liability remains unpaid then it is to be realized from partners in their profit sharing ratio*).
- Piecemeal distribution involves either of two methods
  - Maximum loss method
  - Highest relative capital method.

Unit – 2 : Amalgamation, Conversion and Sale of Partnership Firms

Learning Objectives

After studying this unit, you will be able to :

- Understand the procedure for amalgamation of partnership firms.
- Learn the accounting treatment when a partnership firm is converted in the form of a company.
- Distribute the shares received as purchase consideration among the partners.

2.1 Amalgamation of Partnership Firms

When two or more partnership firms are amalgamated, the books of old firm are closed and books of the new firm are opened.

The accounting procedures for the same are:

2.1.1 Closing the books of old firm

(a) Each firm should prepare a **Revaluation Account** relating to its own assets and liabilities and transfer the balance to the partners' capital accounts in the profit-sharing ratio.

(b) Entries for **raising goodwill** should be passed.

(c) **Assets and liabilities not taken over** by the new firm should be transferred to the capital accounts of partners in the ratio of their capitals.

(d) The **new firm** should be debited with the difference between the value of assets and liabilities taken over by it; the assets should be credited and liabilities debited.

(e) **Partners' capital accounts** should be transferred to the new firm's account;

2.1.2 Opening the books of the new firm

Debit assets taken out at the agreed values

Credit the liabilities taken over, and

Credit individual partner's capital accounts with the closing balances in the erstwhile firm.

When one firm is merged with another existing firm, entries will be in the pattern of winding up in the books of the firm which has ceased to exist. The other firm will record the transaction as that of a business purchase.

Illustration 1

B and S are partners of S & Co. sharing profits and losses in the ratio of 3:1. S and T are partners of T & Co. sharing profits and losses in the ratio of 2:1.

On 31st October, 2012, they decided to amalgamate and form a new firm M/s. BST & Co.

wherein B, S and T would be partners sharing profits and losses in the ratio of 3:2:1.

Their balance sheets on that date were as under:

Liabilities	S & Co. ₹	T & Co. ₹	Assets	S & Co. ₹	T & Co. ₹
Due to X & Co.	40,000	–	Cash in hand	10,000	5,000
Due to S & Co.	–	50,000	Cash at bank	15,000	20,000
Other Creditors	60,000	58,000	Due from T & Co.	50,000	–
Reserves	25,000	50,000	Due from X & Co.	–	30,000
Capitals			Other Debtors	80,000	1,00,000
B	1,20,000	–	Stock	60,000	70,000
S	80,000	1,00,000	Furniture	10,000	3,000
T	–	50,000	Vehicles	–	80,000
			Machinery	75,000	–
			Building	25,000	
	3,25,000	3,08,000		3,25,000	3,08,000

The amalgamated firm took over the business on the following terms :

(a) *Goodwill of S & Co. was worth ₹ 60,000 and that of T & Co. ₹ 50,000. Goodwill account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.*

(b) *Building, machinery and vehicles were taken over at ₹ 50,000, ₹ 90,000 and ₹ 1,00,000 respectively.*

(c) *Provision for doubtful debts has to be carried forward at ₹ 4,000 in respect of debtors of S & Co. and ₹ 5,000 in respect of debtors of T & Co.*

You are required to:

(i) *Compute the adjustments necessary for goodwill.*

(ii) *Pass the journal entries in the books of BST & Co. assuming that excess/deficit capital (taking T's Capital as base) with reference to share in profits are to be transferred to current accounts.*

Solution

(i) Adjustment for raising & writing off of goodwill:

	Raised in old profit sharing ratio				Written off in new ratio		Difference	
	S & Co.	T & Co.	Total					
	₹	₹	₹		₹		₹	
B	45,000	-	45,000	Cr.	55,000	Dr.	10,000	Dr.

S	15,000	33,333	48,333	Cr.	36,666	Dr.	11,667	Cr.
T	–	16,667	16,667	Cr.	18,334	Dr.	1,667	Dr.
	60,000	50,000	1,10,000		1,10,000			

Books of BST & Co.

Journal Entries

2012			*Dr.* ₹	*Cr.* ₹
Oct. 31	Cash Account	Dr.	10,000	
	Bank Account	Dr.	15,000	
	T & Co.	Dr.	50,000	
	Sundry Debtors	Dr.	80,000	
	Stock Account	Dr.	60,000	
	Furniture Account	Dr.	10,000	
	Machinery Account	Dr.	90,000	
	Building Account	Dr.	50,000	
	To Provision for Doubtful debts			4,000
	To X & Co.			40,000
	To Sundry Creditors			60,000
	To B's Capital Account			1,65,750
	To S's capital Account			95,250
	(Sundry assets and liabilities of M/s S & Co. taken over at the values stated as per agreement dated.....)			
	Cash Account	Dr.	5,000	
	Bank Account	Dr.	20,000	
	X & Co. Account	Dr.	30,000	
	Sundry Debtors A/c	Dr.	1,00,000	
	Stock Account	Dr.	70,000	
	Furniture Account	Dr.	3,000	
	Vehicles Account	Dr.	1,00,000	
	To Provision for Doubtful Debts			5,000
	To S & Co.			50,000
	To Sundry Creditors			58,000
	To S's Capital Account			1,43,333
	To T's Capital Account			71,667
	(Sundry assets and liabilities of M/s T & Co. taken over at the values stated as per agreement dated...)			

	B's Capital Account	Dr.	10,000	
	T's Capital Account	Dr.	1,667	
	To S's Capital Account			11,667
	(Adjustment in capital accounts consequent on raising goodwill of S & Co. for ₹ 60,000, T & Co. for ₹ 50,000 and writing off the same in the new ratio between B,S,T as per agreement)			
	S & Co.		50,000	
	To T Co.			50,000
	(Mutual indebtedness of S & Co. and T & Co., cancelled on taking over of the two firms)			
	B's Current Account	Dr.	54,250	
	To B's Capital Account			54,250
	(Amount credited to B's Capital to bring capital in profit-sharing ratio)			
	S's Capital Account	Dr.	1,10,250	
	To S's Current Account			1,10,250
	(Excess amount in S's Capital Account transferred to S's current account to reduce the balance in capital accounts in accordance with the profit sharing ratio)			

Working Notes :

(i) Balance of Capital Accounts on transfer of business to M/s BST & Co.

		B's Capital	*S's Capital*
(a) S & Co.	₹	₹	₹
As per Balance Sheet		1,20,000	80,000
Credit for Reserve		18,750	6,250
Profit on Revaluation	40,000		
Less : Provision for doubtful debts	(4,000)	27,000	9,000
		1,65,750	95,250
(b) T & Co.		*S's Capital*	*T's Capital*
	₹	₹	₹
As per Balance Sheet		1,00,000	50,000
Credit for Reserve		33,333	16,667
Profit on Revaluation	20,000		
Less : Provision for doubtful debts	(5,000)	10,000	5,000
		1,43,333	71,667

(ii) Capital in the new firm

	B ₹	S ₹	T ₹
Balance as taken over	1,65,750	95,250	
	-	1,43,333	71,667
	1,65,750	2,38,583	71,667
Adjustment for Goodwill	–10,000	+11,667	–1,667
	1,55,750	2,50,250	70,000
Total capital, ₹ 4,20,000* in the new ratio of 3:2:1, taking T's Capital as the basis	2,10,000	1,40,000	70,000
Transfer to Current Account	54,250 (Dr.)	1,10,250 (Cr.)	—

*T's Capital is ₹ 70,000 and it is 1/6 of total. The total therefore is ₹ 4,20,000.

Illustration 2

On 31st March 2012, Sri Raman acquires on payment of ₹ 80,000 the business of M/s Gupta and Singh taking over at book value the following assets and liabilities :

	₹
Debtors	*35,000*
Furniture	*3,000*
Stock	*46,000*
Creditors	*10,000*

There was no change between 1st January, 2012 and 31st March, 2012 in the book value of the assets and liabilities not taken over.

The same set of books has been continued after the acquisition and no entries of the acquisition have been passed except for the payment of ₹ 80,000 made by Sri Raman.

From the following balance sheet and trial balance prepare Business Purchase Account, Profit and Loss Account for the year ended 31st December, 2012 and Balance Sheet at that date.

Balance Sheet as at December, 2011

Liabilities		₹	*Assets*	₹
Capital Accounts			*Furniture*	*3,000*
Sri Gupta	*30,000*		*Investments*	*5,000*
Sri Singh	*20,000*	*50,000*	*Insurance Policy*	*2,000*
Bank Loan		*18,000*	*Stock*	*40,000*
Creditors		*12,000*	*Debtors*	*30,000*
		80,000		*80,000*

On 31st December 2012 the trial balance is:

	₹	₹
Stock	*40,000*	
Furniture	*3,000*	
Investment	*5,000*	
Insurance Policy	*2,000*	
Business Purchase Account	*80,000*	
Bank Loan		*18,000*
Capital :		
Gupta		*30,000*
Singh		*20,000*
Raman		*30,000*
Bank	*3,000*	
Debtors	*48,000*	
Creditors		*15,000*
Purchases	*3,20,000*	
Expenses	*12,000*	
Sales		*4,00,000*
	5,13,000	*5,13,000*
Closing Stock ₹ 50,000		

Solution

Business Purchase Account

2012	₹	*2012*	₹
Dec. 31			
To Balance b/d	80,000	By Bank Loan	18,000
To Investments	5,000	By Gupta's Capital A/c	30,000
To Insurance Policy	2,000	By Singh's Capital A/c	20,000
		By Goodwill	6,000
		By Profit & Loss A/c	13,000
		(Balancing figure, profit upto 31st March, 2012)	
	87,000		87,000

Profit & Loss Account of Raman for the year ended 31st December, 2012

	₹		₹
To Opening Stock	40,000	By Sales	4,00,000
To Purchases	3,20,000	By Closing Stock	50,000
To Expenses	12,000		
To Business Purchase			
(Profit upto 31st March)	13,000		
To Net Profit			
Raman's Capital A/c	65,000		
	4,50,000		4,50,000

Balance Sheet of Raman as on 31st December, 2012

Liabilities		₹	*Assets*	₹
Raman's Capital A/c	30,000		Goodwill	6,000
Add : Profit	65,000	95,000	Furniture	3,000
Sundry Creditors		15,000	Stock in trade	50,000
			Sundry Debtors	48,000
			Cash at Bank	3,000
		1,10,000		1,10,000

Working Notes :

(1) *Goodwill*

	₹
Value of Assets taken over	
Stock	46,000
Debtors	35,000
Furniture	3,000
	84,000
Less : Creditors	(10,000)
Net assets	74,000
Goodwill (Balancing figure)	6,000
Purchase Consideration	80,000

(2) *Increase in net assets upto 31st March 2012* :

	as on 1st January ₹	*as on 31st March* ₹
Debtors	30,000	35,000
Stock	40,000	46,000
Furniture	3,000	3,000
	73,000	84,000
Less : Creditors	(12,000)	(10,000)
	61,000	74,000
Profit, equal to net increase	13,000	–
	74,000	74,000

Illustration 3

Firm X & Co. consists of partners A and B sharing Profits and Losses in the ratio of 3 : 2. The firm Y & Co. consists of partners B and C sharing Profits and Losses in the ratio of 5 : 3.

On 31st March, 2012 it was decided to amalgamate both the firms and form a new firm XY & Co., wherein A, B and C would be partners sharing Profits and Losses in the ratio of 4:5:1.

Balance Sheet as at 31.3.2012

Liabilities	*X & Co.*	*Y & Co.*	*Assets*	*X & Co.*	*Y & Co.*
	₹	₹		₹	₹
Capital:			*Cash in hand/bank*	*40,000*	*30,000*
A	*1,50,000*	---	*Debtors*	*60,000*	*80,000*
B	*1,00,000*	*75,000*	*Stock*	*50,000*	*20,000*
C	---	*50,000*	*Vehicles*	---	*90,000*
Reserve	*50,000*	*40,000*	*Machinery*	*1,20,000*	---
Creditors	*1,20,000*	*55,000*	*Building*	*1,50,000*	---
	4,20,000	*2,20,000*		*4,20,000*	*2,20,000*

The following were the terms of amalgamation:

(i) Goodwill of X & Co., was valued at ₹ 75,000. Goodwill of Y & Co. was valued at ₹ 40,000. Goodwill account not to be opened in the books of the new firm but adjusted through the Capital accounts of the partners.

(ii) Building, Machinery and Vehicles are to be taken over at ₹ 2,00,000, ₹ 1,00,000 and ₹ 74,000 respectively.

(iii) *Provision for doubtful debts at ₹ 5,000 in respect of X & Co. and ₹ 4,000 in respect of Y & Co. are to be provided.*

You are required to:

(i) *Show, how the Goodwill value is adjusted amongst the partners.*

(ii) *Prepare the Balance Sheet of XY & Co. as at 31.3.2012 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency to be kept in the respective Partners' Current accounts.*

Solution

(i) Adjustment for raising and writing off of goodwill

	Raised in old profit sharing ratio		*Total*	Written off in new ratio	Difference
	X & Co.	Y & Co.			
	3:2 ₹	5:3 ₹	₹	₹	₹
A	45,000	---	45,000 Cr.	46,000 Dr.	1,000 Dr.
B	30,000	25,000	55,000 Cr.	57,500 Dr.	2,500 Dr.
C	---	15,000	15,000 Cr.	11,500 Dr.	3,500 Cr.
	75,000	40,000	1,15,000	1,15,000	Nil

(ii) Balance Sheet of X Y & Co.(New firm) as on 31.3.2012

Liabilities	₹	**Assets**	₹
Capital Accounts:		Vehicle	74,000
A	1,72,000	Machinery	1,00,000
B	2,15,000	Building	2,00,000
C	43,000	Stock	70,000
Current Accounts:		Debtors	1,31,000
A	22,000	Cash & Bank	70,000
C	18,000		
Creditors	1,75,000		
	6,45,000		6,45,000

Working Notes:

1. Balance of Capital Accounts at the time of amalgamation of firms

	A's Capital ₹	*B's Capital* ₹
X & Co. Profit and loss sharing ratio 3:2		
Balance as per Balance Sheet	1,50,000	1,00,000

Add: Reserves	30,000	20,000
Revaluation profit (Building)	30,000	20,000
Less: Revaluation loss (Machinery)	(12,000)	(8,000)
Provision for doubtful debt	(3,000)	(2,000)
	1,95,000	1,30,000
	B's Capital	*C's Capital*
Y & Co. Profit and loss sharing ratio 5:3	₹	₹
Balance as per Balance sheet	75,000	50,000
Add: Reserves	25,000	15,000
Less: Revaluation (vehicle)	(10,000)	(6,000)
Provision for doubtful debts	(2,500)	(1,500)
	87,500	57,500

2. Balance of Capital Accounts in the balance sheet of the new firm as on 31.3.2012

	A ₹	*B* ₹	*C* ₹
Balance b/d: X & Co.	1,95,000	1,30,000	--
Y & Co.	--	87,500	57,500
	1,95,000	2,17,500	57,500
Adjustment for goodwill	(1,000)	(2,500)	3,500
	1,94,000	2,15,000	61,000
Total capital ₹ 4,30,000 (B's capital* i.e. ₹ 2,15,000 x 2) to be contributed in 4:5:1 ratio.	1,72,000	2,15,000	43,000
Transfer to Current Account	22,000	---	18,000

2.2 Conversion of Partnership Firm into a Company

At times partnerships also are reconstructed like joint stock companies, with the help of creditors if they are satisfied that if by taking of further risk or forgoing a part of the debt, the chances of recovery of their loan and capital would improve.

It usually entails preparation of Reconstruction Account for determining the past losses which belong to old partners and writing them off to the debit of their capital accounts. If a creditor agrees to join as a partner the whole or only a part of the account standing to the credit of his

* B's Capital ₹ 21,500 being one-half of the total capital of the firm.

loan account is transferred to his capital account. For the further development of the business, usually some fresh capital/loan is required. The amount of loan is placed to the credit of the party contributing the same on such terms and conditions as may have been agreed upon.

When the partnership firm is converted into a company, then the financial statements of the new company will be prepared according to Schedule III to the Companies Act, 2013. The general instructions for preparation of Balance sheet and the Statement of Profit and Loss of the company are given in Schedule III to the Companies Act, 2013.

Illustration 4

The following is the Balance Sheet of Messers A and B as on 31st March 2011 :

Liabilities		*₹*	*Assets*	*₹*
A's Capital	*40,000*		*Land and Buildings*	*50,000*
B's Capital	*50,000*	*90,000*	*Stock*	*30,000*
A's Loan		*10,000*	*Debtors*	*20,000*
General Reserve		*10,000*	*Investment*	
Liabilities		*20,000*	*6% Debentures in X Ltd.*	*20,000*
			Cash	*10,000*
		1,30,000		*1,30,000*

It was agreed that Mr. C is to be admitted for a fifth share in the future profits from 1st April 2011. He is required to contribute cash towards goodwill and ₹ 10,000 towards capital.

The following further information is furnished :

(i) The partners A and B shared the profits in the ratio 3:2.

(ii) Mr. A was receiving a salary of ₹ 500 p.m. from the very inception of the firm in 1998 in addition to share of profit.

(iii) The future profit ratio between A, B and C will be 3:1:1. Mr. A will not get any salary after the admission of Mr. C.

(iv) (a) The goodwill of the firm shall be determined on the basis of 2 years' purchase of the average profits from business of the last 5 years. The particulars of the profits are as under :

			₹
Year ended	*31-3-07*	*Profit*	*20,000*
Year ended	*31-3-08*	*Loss*	*10,000*
Year ended	*31-3-09*	*Profit*	*20,000*
Year ended	*31-3-10*	*Profit*	*25,000*
Year ended	*31-3-11*	*Profit*	*30,000*

The above profits and losses are after charging the salary of Mr. A. The profit of the

year ended 31st March 2007 included an extraneous profit of ₹ 30,000 and the loss of the year ended 31st March 2008 was on account of loss by strike to the extent of ₹ 20,000.

(b) *It was agreed that the value of the goodwill of the firm shall appear in the books of the firm.*

(v) *The trading profit for the year ended 31st March, 2012 was ₹ 40,000 before depreciation.*

(vi) *The partners had drawn each ₹ 1,000 p.m. as drawings.*

(vii) *The value of the other assets and liabilities as on 31st March, 2012 were as under :*

	₹
Building (before depreciation)	*60,000*
Stock	*40,000*
Debtors	*Nil*
Investment	*20,000*
Liabilities	*Nil*

(viii) *Provide depreciation at 5% on land and buildings on the closing balance and interest at 6% on A's loan.*

(ix) *They applied for conversion of the firm into a Private Limited Company i.e. ABC Pvt. Ltd.. Certificate received on 1-4-2012. They decided to convert Capital A/cs of the partners into share capital in the ratio of 3 : 1 :1 on the basis of total Capital as on 31-3-2012. If necessary, partners have to subscribe to fresh capital or withdraw.*

Prepare the Statement of Profit and Loss for the year ended 31st March, 2012 and the Balance Sheet of the company.

Solution

Messers A, B and C
Statement of Profit & Loss for the year ended on 31st March, 2012

	₹		₹
To Dep. Building	3,000	By Trading Profit	40,000
To Interest on A's loan	600	By Interest on Debentures	1,200
To Net Profit to :			
A's Capital A/c	22,560		
B's Capital A/c	7,520		
C's Capital A/c	7,520		
	41,200		41,200

Balance Sheet of the ABC Pvt Ltd. as on 1-4-2012

		Notes No.	₹
I	**Equity and Liabilities**		
	Shareholders funds		1,59,120
	Non-current liabilities		
	Long term borrowings	1	10,600
	Total		1,69,720
	Assets		
	Non-current assets		
	Fixed assets		
	Tangible assets	2	57,000
	Intangible assets	3	39,600
	Non-current investments		20,000
	Current assets		
	Inventories		40,000
	Cash and cash equivalents		13,120
	Total		1,69,720

Notes to Accounts

		₹
1.	Long term borrowings	
	Loan from A	10,600
2.	Tangible asset	
	Land and Building	57,000
3.	Intangible asset	
	Goodwill	39,600
4.	Other income	
	Interest on debentures	1,200
5.	Finance cost	
	Interest on A's loan	600

Working Notes:

1. Calculation of goodwill:

Year ended March, 31

	2007 ₹	*2008* ₹	*2009* ₹	*2010* ₹	*2011* ₹
Book Profits	20,000	(10,000)	20,000	25,000	30,000
Adjustment for extraneous profit 2007 and abnormal loss 2008	(30,000)	20,000	—	—	—

	(10,000)	10,000	20,000	25,000	30,000
Add Back: Remuneration of A	6,000	6,000	6,000	6,000	6,000
	(4,000)	16,000	26,000	31,000	36,000
Less : Debenture Interest being non-operating income*	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)
	(5,200)	14,800	24,800	29,800	34,800
Total Profit from 2008 to 2011					1,04,200
Less : Loss for 2007					(5,200)
					99,000
Average Profit					19,800
Goodwill equal to 2 years' purchase					39,600
Contribution from C, equal to 1/5					7,920

2. **Partners' Capital Accounts**

	A ₹	B ₹	C ₹		A ₹	B ₹	C ₹
To Drawings	12,000	12,000	12,000	By Balance b/d	40,000	50,000	—
To Balance c/d	80,320	65,360	13,440	By General Reserve	6,000	4,000	—
				By Goodwill	23,760	15,840	—
				By Bank	—	—	17,920
				By Profit & Loss A/c	22,560	7,520	7,520
	92,320	77,360	25,440		92,320	77,360	25,440

3. **Balance Sheet as on 31st March, 2012**

Liabilities	₹	₹	*Assets*	₹	₹
A's Capital		80,320	Goodwill		39,600*
B's Capital		65,360	Land & Building	60,000	
C's Capital		13,440	*Less* : Dep.	(3,000)	57,000
A's Loan	10,000		Investments		20,000
Add : Int. due	600	10,600	Stock-in-trade		40,000
			Cash (Balancing figure)		13,120**
		1,69,720			1,69,720

4. Conversion into Company

		₹
Capital :	A	80,320
	B	65,360
	C	13,440
Share Capital		1,59,120
Distribution of share :	A (3/5)	95,472
	B (1/5)	31,824
	C (1/5)	31,824

A should subscribe shares of ₹ 15,152 (₹ 95,472 – ₹ 80,320) and C should subscribe shares of ₹ 18,384 (₹ 31,824 – ₹ 13,440) B withdraws ₹ 33,536 (₹ 65,360 – ₹ 31,824) subscribing to shares worth ₹ 31,824.

* It is shown in the books of the firm only to determine the closing capital of partners inclusive of goodwill before conversion.

** Also the closing cash balance can be derived as shown below :

	₹	₹
Trading profit (assume realised)		40,000
Add: Debenture Interest		1,200
Add: Decrease in Debtors Balance		20,000
		61,200
Less: Increase in stock	10,000	
Less: Decrease in Liabilities	20,000	(30,000)
Cash Profit		31,200
Add: Opening cash balance		10,000
Add: Cash brought in by C		17,920
		59,120
Less: Drawings	36,000	
Less: Additions to Building	10,000	(46,000)
		13,120

Illustration 5

Hari, Lal and Jay have been in partnership for a number of years, sharing profits/losses in the ratio of 2:2:1 as wholesale stationers trading under the name 'Hari Brothers'. They decide to convert their partnership into a limited company (with effect from 1st January, 2013) to be known as Hari Ltd.

Immediately prior to this conversion the balance sheet of partnership as at 31st December 2012 was as follows:

Balance Sheet

As on 31st December 2012

Liabilities	₹	₹	*Assets*	₹
Capital accounts			*Fixed assets*	
Hari	*70,000*		*(at written down value)*	
Lal	*30,000*		*Land & Buildings*	*50,000*
Jay	*20,000*	*1,20,000*	*Plant & Machinery*	*30,000*
Current accounts			*Motor vehicles*	*20,000*
Hari	*7,000*		*Current Assets:*	
Lal	*5,000*		*Inventories*	*60,000*
Jay	*3,000*	*15,000*	*Debtors*	*25,000*
Current liabilities			*Axis Bank account*	*5,000*
Creditors	*25,000*			
Dena Bank account	*20,000*	*45,000*		
Long-term liabilities				
Loan-Hari	*3,000*			
Loan-Gopi Ltd.	*7,000*	*10,000*		
		1,90,000		*1,90,000*

The terms of conversion are that Hari Ltd. is to take over the assets and liabilities of Hari Brothers as follows:

	Valuation for take-over ₹
Land and Building	*96,000*
Plant and Machinery	*28,000*
Motor vehicles	*15,000*
Inventories	*60,000*
Debtors	*24,000*
Creditors	*25,000*
Goodwill	*10,000*

The closing balance in Axis Bank account is to be transferred to Dena Bank account before all the other dissolution entries are effected in the partnership ledgers.

Lal took over one of the motor vehicles at an agreed amount of ₹ 2,000. All other liabilities were paid from the Dena Bank account.

The purchase consideration is discharged by an issue at par of ₹ 60,000 10% Debentures (fully paid) to the partners in their capital account proportions as shown in the above balance sheet plus equity shares in Hari Ltd. of ₹ 1 each (fully paid to make up the balance due to each partner).

You are required to

(i) prepare (a) Realisation Account (b) Partners' Capital Accounts (c) Bank account of Axis Bank and Dena Bank in the books of Hari Brothers;

(ii) 'Business purchase account' and 'Hari Brothers' account in Hari Ltd.'s books.

Solution

(i) (a) In the books of Hari Brothers

Realisation Account

		₹	₹			₹
To	Land and buildings		50,000	By	Creditors	25,000
To	Plant and machinery		30,000	By	Lal's capital A/c	2,000
To	Motor vehicles		20,000	By	Dena Bank A/c	25,000
To	Inventories		60,000	By	Hari Ltd.	1,83,000
To	Debtors		25,000			
To	Partners' capital accounts					
	Hari (2/5)	20,000				
	Lal (2/5)	20,000				
	Jay (1/5)	10,000	50,000			
			2,35,000			2,35,000

(b) Partners' Capital Accounts

	Particulars	Hari ₹	Lal ₹	Jay ₹		Particulars	Hari ₹	Lal ₹	Jay ₹
To	Realisation A/c(motor vehicle takeover)		2,000		By	Balance b/d	70,000	30,000	20,000
To	10% Debentures*	35,000	15,000	10,000	By	Current A/c	7,000	5,000	3,000
To	Equity shares	62,000	38,000	23,000	By	Realisation A/c Profit	20,000	20,000	10,000
		97,000	55,000	33,000			97,000	55,000	33,000

*** Debentures have been issued in proportion of capital account balances i.e. in ratio of 7:3:2.**

(c) **Bank Account**

	Particulars	Axis Bank	Dena Bank		Particulars	Axis Bank	Dena Bank
		₹	₹			₹	₹
To	Balance b/d	5,000	-	By	Balance b/d	-	20,000
To	Axis Bank	-	5,000	By	Loan (Gopi Ltd.)	-	7,000
To	Realisation A/c	-	25,000	By	Loan-Hari	-	3,000
				By	Dena Bank	5,000	
		5,000	30,000			5,000	30,000

(ii) **In the books of Hari Ltd.**

Business Purchase Account

		₹			₹
To	Creditors	25,000	By	Land and buildings	96,000
To	Dena Bank (overdraft)	25,000	By	Plant and Machinery	28,000
To	Hari Brothers	1,83,000	By	Motor Vehicles	15,000
			By	Inventories	60,000
			By	Debtors	24,000
			By	Goodwill	10,000
		2,33,000			2,33,000

Hari Brothers Account

		₹		₹
To	10% Debentures A/c	60,000	By Business purchase	1,83,000
To	Equity share capital A/c	1,23,000		
		1,83,000		1,83,000

Partnership-Sale to a Company

Illustration 6

A and B were carrying on business sharing profits and losses equally. The firm's Balance Sheet as at 31.12.2011 was:

Liabilities	₹	*Assets*	₹
Sundry Creditors	*60,000*	*Stock*	*60,000*
Bank overdraft	*35,000*	*Machinery*	*1,50,000*
Capital A/cs:		*Debtors*	*70,000*

A	*1,40,000*		*Joint Life Policy*		*9,000*
B	*1,30,000*	*2,70,000*	*Leasehold Premises*		*34,000*
			Profit & Loss A/c		*26,000*
			Drawings Accounts:		
			A	*10,000*	
			B	*6,000*	*16,000*
		3,65,000			*3,65,000*

The business was carried on till 30.6.2012. The partners withdrew in equal amounts half the amount of profits made during the period of six months after charging depreciation at 10% p.a. on machinery and after writing off 5% on leasehold premises. In the half year, sundry creditors were reduced by ₹ 10,000 and bank overdraft by ₹ 15,000.

On 30.6.2012, stock was valued at ₹ 75,000 and Debtors at ₹ 60,000; the Joint Life Policy had been surrendered for ₹ 9,000 before 30.6.2012 and other items remained the same as at 31.12.2011.

On 30.6.2012, the firm sold the business to a Limited Company. The value of goodwill was fixed at ₹ 1,00,000 and the rest of the assets were valued on the basis of the Balance Sheet as at 30.6.2012. The company paid the purchase consideration in Equity Shares of ₹ 10 each.

You are required to prepare: (a) Balance Sheet of the firm as at 30.6.2012; (b) The Realisation Account; (c) Partners' Capital Accounts showing the final settlement between them.

Solution

(a) **Balance Sheet as on 30.6.2012**

Liabilities	₹	₹	*Assets*	₹	₹
Capital Accounts:			Machinery	1,50,000	
A's balance as on 1.1.2012	1,17,000		*Less*: Depreciation @ 10% p.a.	(7,500)	1,42,500
Add: Profit for 6 months	11,800		Leasehold premises	34,000	
	1,28,800		*Less*: Written-off @ 5%	(1,700)	32,300
Less: Drawings for 6 months	(5,900)	1,22,900	Stock		75,000
B's balance as on 1.1.2012	1,11,000		Sundry Debtors		60,000
Add: Profit for 6 months	11,800				
	1,22,800				
Less: Drawings for 6					

months	(5,900)	1,16,900		
Sundry Creditors		50,000		
Bank overdraft		20,000		
		3,09,800		3,09,800

(b) **Realisation Account**

	Particulars	₹		Particulars	₹
To	Machinery A/c	1,42,500	By	Sundry Creditors A/c	50,000
To	Leasehold Premises A/c	32,300	By	Bank Overdraft A/c	20,000
To	Stock A/c	75,000	By	Limited Company A/c (W.N.2)	3,39,800
To	Sundry Debtors A/c	60,000			
To	A's Capital A/c	50,000			
To	B's Capital A/c	50,000			
		4,09,800			4,09,800

(c) **Partners' Capital Accounts**

Date	Particulars	A	B	Date	Particulars	A	B
		₹	₹			₹	₹
1.1.12	To Profit & Loss A/c	13,000	13,000	1.1.12	By Balance b/d	1,40,000	1,30,000
	To Drawings A/c	10,000	6,000				
29.6.12	To Balance c/d	1,17,000	1,11,000				
		1,40,000	1,30,000			1,40,000	1,30,000
30.6.12	To Drawings A/c	5,900	5,900	30.6.12	By Balance b/d	1,17,000	1,11,000
	To Shares in Limited Company A/c	1,72,900	1,66,900	30.6.12	By Profit & Loss Appropriation A/c	11,800	11,800
					By Realisation A/c	50,000	50,000
		1,78,800	1,72,800			1,78,800	1,72,800

Working Notes:

(1) Ascertainment of profit for the 6 months ended 30th June, 2012

Closing Assets:	₹	₹
Stock		75,000
Sundry Debtors		60,000
Machinery less depreciation		1,42,500

Leasehold premises less written off		32,300
		3,09,800
Less: Closing liabilities:		
Sundry Creditors	50,000	
Bank overdraft	20,000	(70,000)
Closing Net Assets		2,39,800
Less: Opening combined capital:		
A – ₹ (1,40,000 – 13,000 – 10,000)	1,17,000	
B – ₹ (1,30,000 – 13,000 – 6,000)	1,11,000	(2,28,000)
Profit before adjustment of drawings		11,800
Add: Combined drawings during the 6 months (equal to profit)		11,800
Profit for 6 months		23,600

(2) Ascertainment of purchase consideration:

Closing net assets (as above) ₹ 2,39,800 + Goodwill ₹ 1,00,000 = ₹ 3,39,800.

Illustration 7

A, B and C were in partnership sharing profits and losses 3:2:1. There was no provision in the agreement for interest on capitals or drawings.

A died on 31.12.2011 and on that date, the partners' balance were as under:

Capital Account : A – ₹ 60,000; B- ₹ 40,000; C- ₹ 20,000

Current Account: A – ₹ 29,000; B – ₹ 20,000; C – ₹ 5,000 (Dr.).

By the partnership agreement, the sum due to A's estate was required to be paid within a period of 3 years, and minimum instalment of ₹ 20,000 each were to be paid, the first such instalment falling due immediately after death and the subsequent instalments at half-yearly intervals. Interest @ 5% p.a. was to be credited half-yearly.

In ascertaining his share, goodwill (not recorded in the books) was to be valued at ₹ 60,000 and the assets, excluding the Joint Endowment Policy (mentioned below), were valued at ₹ 36,000 in excess of the book values.

No Goodwill Account was raised and no alteration was made to the book values of fixed assets. The Joint Assurance Policy shown in the books at ₹ 20,000 matured on 1.1.2011, realising ₹ 26,000; payments of ₹ 20,000 each were made to A's Executors on 1.1.2011, 30.6.2011 and 31.12.2011. B and C continued trading on the same terms as previously and the net profit for the year to 31.12.2011 (before charging the interest due to A's estate) amounted to ₹ 32,000. During that period, the partners drawings were: B- ₹ 15,000; and C- ₹ 8,000.

On 1.1.2012, the partnership was dissolved and an offer to purchase the business as a going concern for ₹ 1,40,000 was accepted on that day. A cheque for that sum was received on 30.6.2012.

The balance due to A's estate, including interest, was paid on 30.6.2012 and on that day, B and C received the sums due to them.

You are required to write-up the Partners' Capital and Current Accounts from 1.1.2011 to 30.6.2012. Show also the account of the executors of A.

Solution

Partners' Current Accounts

Particulars	A	B	C	Particulars	A	B	C
1.1.2011	₹	₹	₹	1.1.2011	₹	₹	₹
To Balance b/d	---	----	5,000	By Balance b/d	29,000	20,000	--
To A's Current A/c – goodwill	-	20,000	10,000	By B's Current A/c – goodwill	20,000	--	--
To A's Current A/c – Revaluation Profit	-	12,000	6,000	By C's Current A/c – goodwill	10,000	-	-
To A's Capital A/c – transfer	80,000	-	-	By B's Current A/c – Revaluation profit	12,000	-	-
				By C's Current A/c – Revaluation profit	6,000		
				By Joint Life Policy A/c (₹ 26,000 – ₹ 20,000)	3,000	2,000	1,000
				By Balance c/d		10,000	20,000
	80,000	32,000	21,000		80,000	32,000	21,000
1.1.2011				31.12.2011			
To Balance b/d		10,000	20,000	By Profit & Loss Appropriation A/c		17,617	8,808
31.12.2011				By Balance c/d		7,383	19,192
To Drawings A/c		15,000	8,000				
		25,000	28,000			25,000	28,000
1.1.2012				30.6.2012			
To Balance b/d		7,383	19,192	By Realisation A/c - profit		12,573	6,287
To B's Capital A/c – transfer		5,190	---	By C's Capital A/c - transfer		---	12,905
		12,573	19,192			12,573	19,192

Partners' Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
1.1.2011	₹	₹	₹	1.1.2011	₹	₹	₹
To A's Executors A/c	1,40,000	----	---	By Balance b/d	60,000	40,000	20,000
To Balance c/d	---	40,000	20,000	By A's Current A/c	80,000	--	--
	1,40,000	40,000	20,000		1,40,000	40,000	20,000
31.12.2011				1.1.2011			
To Balance c/d		40,000	20,000	By Balance b/d		40,000	20,000
		40,000	20,000			40,000	20,000
30.6.2012				1.1.2012			
To C's Current A/c – transfer		---	12,905	By Balance b/d		40,000	20,000
To Bank A/c		45,190	7,095	30.6.2012			
				By B's Current A/c – transfer		5,190	---
		45,190	20,000			45,190	20,000

A's Executors Account

Date	Particulars	₹	Date	Particulars	₹
1.1.2011	To Bank A/c	20,000	1.1.2011	To A's Capital A/c	1,40,000
1.1.2011	To Balance c/d	1,20,000			
		1,40,000			1,40,000
30.6.2011	To Bank A/c	20,000	1.1.2011	By Balance b/d	1,20,000
30.6.2011	To Balance c/d	1,03,000	30.6.2011	By Interest A/c	3,000
		1,23,000			1,23,000
31.12.2011	To Bank A/c	20,000	1.7.2011	By Balance b/d	1,03,000
31.12.2011	To Balance c/d	85,575	31.12.2011	By Interest A/c	2,575
		1,05,575			1,05,575
30.6.2012	To Bank A/c	87,715	1.1.2012	By Balance b/d	85,575
			30.6.2012	By Interest A/c	2,140
		87,715			87,715

Working Notes:

(1) Adjustment in regard to Goodwill

Partners		A	B	C
Share of goodwill before death	(₹)	30,000	20,000	10,000
Share of goodwill after death	(₹)	-	40,000	20,000
Gain (+)/Sacrifice (-)	(₹)	(30,000)	20,000	10,000
		Cr.	Dr.	Dr.

(2) Adjustment in regard to revaluation of assets

Partners		A	B	C
Share of profit on revaluation credited to all the partners	(₹)	18,000	12,000	6,000
Debited to the continuing partners	(₹)	-	24,000	12,000
	(₹)	(18,000)	12,000	6,000
		Cr.	Dr.	Dr.

(3) Ascertainment of Profit for the year ended 31.12.2011

	₹	₹
Profit before charging interest on balance due to A's executors		32,000
Less: Interest payable to A's executors:		
from 1.1.2011 to 30.6.2011	3,000	
From 1.7.2011 to 31.12.2011	2,575	(5,575)
Balance of profit to be shared by B and C		26,425

(4) Ascertainment of Profit for the year ended 31.12.2011

Liabilities	₹	*Assets*	₹
Capital Account – B	40,000	Sundry Assets (balancing figure)	1,19,000
Capital Account – C	20,000	Partners' Current A/cs –B	7,383
A's Executors A/c	85,575	Partners' Current A/cs- C	19,192
	1,45,575		1,45,575

(5) Realisation Account

		₹			₹
To	Sundry Assets A/c	1,19,000	By	Bank A/c (purchase consideration)	1,40,000
To	Interest A/c – A's Executors	2,140			
To	Partners' Capital A/cs – B	12,573			
To	Partners' Capital A/cs – C	6,287			
		1,40,000			1,40,000

2.2.1 Apportionment of shares amongst the partners

Sometime an examination problem may require the students to suggest equitable basis for division of shares between the vendors, when they are partners, so as to preserve the rights as previously existed between them, that is, to maintain the same profit-sharing ratio and to preserve the priority in regard to repayment of capital.

Suppose A, B and C share profits and losses in the ratio 3 : 2 : 1 after allowing interest on capital @ 9% p.a. Their capitals on 31st December, 2011 were: A ₹ 50,000, B ₹ 30,000 and C ₹ 20,000. On 1st January, 2012 the business was converted into a limited company and was valued at ₹ 1,30,000. A scheme of capitalisation, whereby the mutual interest of partners may remain intact as far as possible is suggested below:

The total capital being ₹ 1,00,000 and the value placed on the business being ₹ 1,30,000 there is goodwill of ₹ 30,000 to be shared by the partners in the ratio of 3:2:1 or A ₹ 15,000, B ₹ 10,000 and C ₹ 5,000. The capital will now be: A ₹ 65,000, B ₹ 40,000 and C ₹ 25,000.

Taking B's capital as the basis, A's capital should be ₹ 60,000, i.e. 40,000 × 3/2 and C's capital should be ₹ 20,000. Both A and C have ₹ 5,000 excess. Since interest on capital is meant to compensate those whose capital is in excess of proportionate limits and since in the case of partners it is an appropriation of profit, it will be proper to give 9% preference shares to A & C for ₹ 5,000 each and the remaining amount of ₹ 1,20,000 can be in the form of equity shares to be divided among A, B and C in the ratio of 3 : 2 : 1. They will then share the company's profit in the ratio of 3 : 2 : 1 after allowing preference dividend.

Illustration 8

Prabhu & Co. is a partnership firm consisting of Mr. Prabhu, Mr. Bhola and Mr. Shiv who share profits and losses in the ratio of 2:2:1 and Bhagwan Ltd. is a company doing similar business.

Following is the Balance sheet of the firm and that of the company as at 31.3.2012:

Liabilities	*Prabhu & Co.*	*Bhagwan Ltd.*		*Prabhu & Co.*	*Bhagwan Ltd.*
	₹	*₹*		*₹*	*₹*
Equity share Capital:			*Plant & machinery*	*2,50,000*	*8,00,000*
Equity shares of ₹ 10 each		*10,00,000*	*Furniture & fixture*	*25,000*	*1,12,500*
			Stock in trade	*1,00,000*	*4,25,000*
Partners' capital:			*Sundry debtors*	*1,00,000*	*4,12,500*
Prabhu	*1,00,000*		*Cash at bank*	*5,000*	*2,00,000*
Bhola	*1,50,000*		*Cash in hand*	*20,000*	*50,000*
Shiv	*50,000*				
General reserve	*50,000*	*3,50,000*			
Sundry creditors	*1,50,000*	*6,50,000*			
	5,00,000	*20,00,000*		*5,00,000*	*20,00,000*

It was decided that the firm Prabhu & Co. be dissolved and all the assets (except cash in hand and cash at bank) and all the liabilities of the firm be taken over by Bhagwan Ltd. by issuing 25,000 shares of ₹ 10 each at a premium of ₹ 2 per share.

Partners of Prabhu & Co. agreed to divide the shares issued by Bhagwan Ltd. in the profit sharing ratio and bring necessary cash for settlement of their capital.

The creditors of Prabhu & Co. includes ₹ 50,000 payable to Bhagwan Ltd. An unrecorded liability of ₹ 12,500 of Prabhu & Co. must also be taken over by Bhagwan Ltd.

Prepare:

(i) Realisation account, Partners' capital accounts and Cash in hand/Bank account in the books of Prabhu & Co.

(ii) Pass journal entries in the books of Bhagwan Ltd. for acquisition of Prabhu & Co.

Solution

(i) In the books of Prabhu & Co.

Realisation Account

	₹		₹
To Plant & Machinery	2,50,000	By Sundry Creditors	1,50,000
To Furniture & Fixture	25,000	By Bhagwan Ltd. (Refer W.N.)	3,00,000
To Stock in trade	1,00,000	By Partners' Capital Accounts (loss):	
To Sundry Debtors	1,00,000	Prabhu's Capital A/c	10,000
		Bhola's Capital A/c	10,000
		Shiv's Capital A/c	5,000
	4,75,000		4,75,000

Partners' Capital Accounts

	Prabhu	Bhola	Shiv		Prabhu	Bhola	Shiv
	₹	₹	₹		₹	₹	₹
To Realisation A/c	10,000	10,000	5,000	By Balance b/d	1,00,000	1,50,000	50,000
To Shares in Bhagwan Ltd.	1,20,000	1,20,000	60,000	By General Reserve	20,000	20,000	10,000
To Cash	-	40,000	-	By Cash	10,000	-	5,000
	1,30,000	1,70,000	65,000		1,30,000	1,70,000	65,000

Cash and Bank Account

	₹	₹		₹	₹
To Balance b/d	20,000	5,000	By Cash A/c (Contra)*		5,000
To Bank A/c (Contra)*	5,000		By Bhola	40,000	
To Prabhu	10,000				

* It is assumed that cash at bank has been withdrawn to pay to Partner Bhola.

To	Shiv	5,000	____		____	____
		40,000	5,000		40,000	5,000

(ii)

In the Books of Bhagwan Ltd.
Journal Entries

			Dr. (₹)	*Cr. (₹)*
1.	Business Purchase Account	Dr.	3,00,000	
	To Liquidators of Prabhu & Co.			3,00,000
	(Being business of Prabhu & Co. purchased and payment due)			
2.	Plant and Machinery A/c	Dr.	2,50,000	
	Furniture and Fixture A/c	Dr.	25,000	
	Stock in Trade A/c	Dr.	1,00,000	
	Sundry Debtors A/c	Dr.	1,00,000	
	To Sundry Creditors			1,50,000
	To Unsecured Liability			12,500
	To Business Purchase Account			3,00,000
	To Capital Reserve (B.F.)			12,500
	(Being take over of all assets and liabilities)			
3.	Liquidators of Prabhu & Co.	Dr.	3,00,000	
	To Equity Share Capital Account			2,50,000
	To Securities Premium Account			50,000
	(Being purchase consideration discharged in the form of shares of ₹ 10 each issued at a premium of ₹ 2 each)			
4.	Sundry Creditors Account	Dr.	50,000	
	To Sundry Debtors Account			50,000
	(Being mutual owing eliminated)			

Working Note:

Computation of purchase consideration:

25,000 Equity shares of ₹ 12 each = ₹ 3,00,000

Equity shares to be given to partners :

Prabhu	=	10,000 Shares @ ₹ 12 = ₹ 1,20,000
Bhola	=	10,000 shares @ ₹ 12 = ₹ 1,20,000
Shiv	=	5,000 shares @ ₹ 12 = ₹ 60,000

Illustration 9

P and Q were carrying on business sharing profits and losses equally. The firm's Balance Sheet as at 31.12.2013 was:

Liabilities		₹	Assets		₹
Capital Accounts:			Plant		1,60,000
P	1,50,000		Building		48,000
Q	1,30,000	2,80,000	Debtors		75,000
Sundry Creditors		80,000	Stock		70,000
Bank Overdraft		45,000	Joint Life Policy		6,000
			Profit & Loss A/c		30,000
			Drawings Account:		
			P	9,000	
			Q	7,000	16,000
		4,05,000			4,05,000

The operations of the business were carried on till 30.06.2014. P and Q both withdrew in equal amount half the amount of profit made during the current period of six months after charging depreciation at 10% per annum on plant and after writing off 5% on building.

During the current period of six months, creditors were reduced by ₹ 20,000 and bank overdraft by ₹ 5,000.

The joint life policy was surrendered for ₹ 6,000 before 30th June 2014. Stock was valued at ₹ 84,000 and debtors at ₹ 68,000 on 30th June 2014. The other items remained the same as at 31.12.2013.

On 30.06.2014, the firm sold its business to PQ Ltd. The value of goodwill was estimated at ₹ 1,30,000 and the remaining assets were valued on the basis of the balance sheet as on 30.06.2014.

PQ Ltd. paid the purchase consideration in equity shares of ₹ 10 each.

You are required to prepare:

(a) Balance sheet of the firm as at 30.06.2014,

(b) Realisation account,

(c) Partners' Capital Accounts showing the final settlement between them. (16 Marks)

Answer

(a) Balance sheet of the firm as at 30.06.2014

Liabilities	₹	*Assets*		₹
Capital Accounts:		Plant :		
P's Capital	1,33,800	Opening Balance	1,60,000	
Q's Capital	1,15,800	*Less*: Depreciation @ 10%	8,000	1,52,000
Creditors	60,000	Building:		
Bank Overdraft	40,000	Opening Balance	48,000	
		Less: Written-off @ 5%	2,400	45,600
		Debtors		68,000
		Stock		84,000
Total	3,49,600	Total		3,49,600

(b) Realisation Account

Dr. *Cr.*

Particulars	*Amount*	*Particulars*	*Amount*
To Sundry Assets:		By Creditors	60,000
Plant	1,52,000	By Bank Overdraft	40,000
Building	45,600		
Stock	84,000	By PQ Limited A/c	3,79,600
Debtors	68,000	(working note 2)	
To Profit:			
P's Capital A/c	65,000		
Q's Capital A/c	65,000		
	4,79,600		4,79,600

(c) Partner's Capital Accounts

Date	*Particulars*	*P (₹)*	*Q (₹)*	*Date*	*Particulars*	*P (₹)*	*Q (₹)*
01.01.14	To Profit & Loss A/c	15,000	15,000	1.1.14	By Balance b/d	1,50,000	1,30,000
01.01.14	To Drawing A/c	9,000	7,000	30.06.14	By Profit (W. N. 1)	15,600	15,600
30.06.14	To Drawing A/c (W. N.1)	7,800	7,800				
30.06.14	To Balance c/d	1,33,800	1,15,800				
	Total	1,65,600	1,45,600		Total	1,65,600	1,45,600
				30.06.14	By Balance b/d	1,33,800	1,15,800

30.06.14	To Shares in PQ Limited	1,98,800	180,800	30.06.14	By Realisation A/c (Profit)	65,000	65,000
		1,98,800	1,80,800			1,98,800	1,80,800

Working Notes

(1) Ascertainment of profit for the period of 6 Months ended 30.06.2014

			Amount (₹)
Closing Assets:			
Stock			84,000
Debtors			68,000
Plant Less Depreciation			1,52,000
Building Less Written off			45,600
Total			3,49,600
Less: Closing Liabilities:			
Creditors		60,000	
Bank Overdraft		40,000	1,00,000
Closing Net Assets			2,49,600
Less: Opening adjusted Capitals			
P (₹1,50,000 – ₹15,000 – ₹9,000)	1,26,000		
Q (₹1,30,000 – ₹15,000 – ₹7,000)	1,08,000		2,34,000
Profit Net of drawings			15,600
Actual Profit for Six Months before drawings(half of profit) = 15,600 x 2			31,200
Combined Drawing during six months (half of profit)			15,600

(2) Ascertainment of purchase consideration

	₹
Closing Net Assets (As above)	2,49,600
Add: Goodwill	1,30,000
Total Purchase Consideration	3,79,600

Summary

- Amalgamation of partnership firms includes
  - Closing the old books of Amalgamating firms
  - Opening the new books of Amalgamated firm
- When one firm is merged with another existing firm, entries will be in the pattern of winding up in the books of the firm which has ceased to exist. The other firm will record the transaction as that of a business purchase.
- Creditors play an important role in conversion of partnership firm into company.